market intelligence

GETTING THE DEAL THROUGH

Volume 1 • Issue 1

Private equity

Bill Curbow leads the global panel • Interviews in 19 key jurisdictions
Cross border transactions • Inside track • Trends for 2014

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GETTING THE DEAL THROUGH

market intelligence

Welcome to *GTDT: Market Intelligence*.

This first issue focuses on the global private equity markets.

Getting the Deal Though invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers an opportunity for readers to gain closer insight into key markets and legal jurisdictions.

Market Intelligence is available in print and online at www.gettingthedealthrough.com.

Getting the Deal Through
London
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In this issue

Panel Leader William Curbow, Simpson Thacher & Bartlett LLP

William E Curbow is a partner at Simpson Thacher & Bartlett LLP and a member of the firm's corporate department where he concentrates on mergers and acquisitions. He recently represented Vodafone Group in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications – the third-largest M&A transaction in history. Bill also frequently represents Simpson Thacher's private equity clients in transactional matters – in particular, First Reserve, a global private equity and infrastructure investment firm exclusively focused on investments across the energy spectrum. Other clients include L-3 Communications, Crestwood Midstream Partners and Genesee & Wyoming.

Here, Curbow and fellow Simpson Thacher partners Atif Azher and Jason Herman look at developments in private equity markets around the world.

GLOBAL TRENDS

WILLIAM CURBOW, ATIF AZHER AND JASON HERMAN OF SIMPSON THACHER & BARTLETT LLP

Global M&A activity levels have been at near-record levels in the first half of 2014, having increased by approximately 73 per cent relative to the first half of 2013 and representing approximately US$1.8 trillion of deal volume. Worldwide private equity buyout transaction activity also increased, though not at the same pace. There were 109 more private equity buyouts in the first half of 2014 as compared to 2013, amounting to US$182.9 billion of deal activity and representing a 9 per cent increase relative to the first half of 2013. One notable bright spot for private equity sponsors was exit activity. As would be expected at a time when valuations remain high, private equity sponsors achieved US$260.2 billion in exits in the first half of 2014, surpassing the previous record set in the first half of 2007.

Americas

M&A deal volume announced in the first half of 2014 in the Americas totalled approximately US$866 billion, reflecting an increase of 63.7 per cent from the first half of 2013. US-based buyout transactions totalled approximately US$80.1 billion in the first half of 2014, which represented approximately 43.8 per cent of all buyouts in the first half of 2014 as compared to US-based buyouts representing nearly 53.5 per cent of all buyouts in the same period last year. Though buyout activity is slightly lagging, Pitchbook reported that United States private equity investors invested nearly US$244 billion of capital in the first half of 2014 as compared to US$192 billion of capital in the first half of 2013. In addition, the number of private equity deals that closed in the United States in the first half of 2014 increased to 1,272 as compared to 1,187 in the first half of 2013. Notable private equity transactions in the Americas in the first half of 2014 include: the US$5.4 billion acquisition of Gates Corporation by affiliates of The Blackstone Group; the US$4.4 billion acquisition of MultiPlan Inc by Partners Group Holding's and Starr Investment Holdings LLC's from affiliates of BC Partners and Silver Lake Partners; the US$4.2 billion acquisition of the ortho-clinical diagnostic business of Johnson & Johnson by affiliates of The Carlyle Group; and TPG's US$750 million minority investment in Chobani Inc and US$450 million minority investment in Airbnb Inc.

Europe, Middle East and Africa

Announced M&A deal volume in Europe, the Middle East and Africa (EMEA) totalled approximately US$697.2 billion in the first half of 2014, an approximate 98 per cent increase in deal volume from the first half of 2013. Of this amount, Europe alone accounted for approximately US$508.8 billion of total M&A deal volume, and realised an approximate 118.5 per cent increase relative to the first half of 2013. EMEA-targeted private equity sponsor buy-side activity totalled approximately US$89.6 billion in the first half of 2014, as compared to US$59.3 billion in the first half of 2013, an increase of approximately 51 per cent.

Asia-Pacific

Announced M&A deal volume in the Asia-Pacific region totalled approximately US$337.8 billion in the first half of 2014, which represented an approximately 82.4 per cent increase from comparable deal volume in the first half of 2013. Notably, Japan did not experience the same M&A activity levels in the first half of 2014 as compared with the rest of Asia. Announced M&A deal volume in Japan totalled approximately US$31.3 billion, representing an approximately 26.4 per cent decrease in the first half of 2014 as compared to the first half of 2014. China remained the most targeted country in the Asia-Pacific region. Interestingly, private equity activity in Asia-Pacific (excluding Japan) in the first half of 2014 was valued at approximately US$38.1 billion, which represents a 161.5 per cent increase as compared to the first half of 2013.

Debt financing markets

Debt financing markets in the United States continue to remain strong in the first half of 2014. The use of leverage by private equity sponsors has increased in the first half of 2014. Through the first six months of 2014, median debt/EBITDA multiples for private equity investments reached 8.2x, which represents a significant increase from 6.9x for all of 2013. In addition, during the first half of 2014, the median leverage percentage for buyouts was 71.6 per cent, as compared to the median of 65.6 per cent for transactions in all of 2013.

Strong first half in private equity fundraising

Private equity fundraising during the first half of 2014 was strong and reflects a continued consolidation within the private equity fundraising market in favour of established sponsors with proven track records. The second quarter saw an acceleration in private equity fundraising to approximately US$132 billion (up from US$104 billion in the first quarter), putting 2014 on pace to be the most successful year for private equity fundraising since the global financial crisis.

While aggregate capital raised by private equity funds has increased, the capital raising environment has become increasingly competitive, and capital is being allocated across a smaller group of sponsors. This has resulted in an increase in average fund size and large/mega funds taking up an increasing share of the private equity fundraising market (accounting for approximately 66 per cent of all capital raised last year by private equity funds and approximately 77 per cent of buyout capital raised).

We expect these trends to continue into the second half of 2014, and as competition for limited partner capital increases and sponsors seek to adapt to the heightened regulations applicable to private equity firms we believe that we will see a continued separation within the fundraising market in favour of established sponsors with proven track records and the fundraising and compliance resources necessary to successfully raise capital in today's environment.

Outlook for second half of 2014

Although private equity activity levels in the first half of 2014 did not keep pace with overall M&A activity levels generally, debt financing markets remain stable. As a result, deal professionals are hopeful that private equity buyout activity will remain strong in the second half of 2014. In addition, given relatively high valuations, many sponsors are in the process of effecting portfolio company exits in order to harvest attractive returns, which increases the number of potentially attractive targets for sponsors looking to put their capital to work.


Atif Azher


Jason Herman

PRIVATE EQUITY IN AUSTRALIA

John Williamson-Noble is a partner in Gilbert + Tobin's corporate advisory group. He has significant experience in mergers and acquisitions, equity capital markets, financial institutions, leveraged buyouts, private equity and venture capital. John was chair of the corporate and M&A committee of the International Bar Association and a member of the investment committee of the private equity fund Crescent Capital Partners.

Tim Gordon is also a partner in Gilbert + Tobin's corporate advisory group. Tim's experience in corporate advisory and corporate transactions includes advising listed and unlisted companies and Australian and offshore private equity fund managers in relation to mergers and acquisitions, corporate restructurings and recapitalisations and business and share sale processes. Tim has advised private equity funds including Crescent Capital, Bain Capital, TA Associates, the Carlyle Group and TPG on recent transactions.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

John Williamson-Noble & Tim Gordon: Private equity funds have been extremely active in Australia in the past 12 months, with high-profile exits such as Crescent Capital's IPO of Cover-More, Quandrant's IPO of Burson and the IPO of Nine garnering a lot of media attention.

On the buy-side, private equity funds have shown renewed activity in Australia, with a significant number of acquisitions completed over the last 12 months and a number of high-profile public-to-private transactions being proposed (such as PEP's proposal to acquire SAI Global and KKR's offer for Treasury Wine Estates).

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

JWN & TG: Straight buyouts remain the most common structure among larger deals, although we are seeing an increase in financial sponsors clubbing together to bid for large assets. Recent examples of this include TPG, PAG Asia Capital and Canada's Ontario Teachers' Pension Plan bid for DTZ and PEP, and KKR who are reportedly considering bidding together for SAI Global. TPG and Carlye used such a structure in respect of Healthscope, which was successfully exited by way of IPO in June 2014.

GTDT: What were the recent keynote deals? And what made them stand out?

JWN & TG: As mentioned above, noteworthy deals on the buy-side include Bain Capital's acquisition of Retail Zoo, the acquisition of UGL's property services unit by TPG and co-investors (A$1.22 billion) as well as the PEP approach for SAI Global (valuing it around A$1.1 billion). Other recent keynote deals include BC Partners' acquisition of Mergermarket (US$624 million) and CHAMP and Headland Capital's acquisition of Miclyn Express (A$620 million).

On the sell-side, there have been a large number of significant private equity exits, most notably including a number of successful IPOs, including those in respect of Cover-More, Healthscope, Nine, Burson and Spotless.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

JWN & TG: Given Australia's relative size when compared with Asian, European and US markets, it is not surprising that a large proportion of private equity M&A is cross-border. Generally, foreign buyers have accounted for around 80 per cent of all public and private M&A deals so far this year.

A challenge that is commonly faced around deal structuring is that warranty insurance is regularly (approximately 50 per cent of the time) used in Australia for private equity deals. This can require an education process for funds based in other jurisdictions where the Australian counterparty is committed to that approach.

As always, time zones are a challenge for US and European funds doing deals in Australia.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

JWN & TG: The private equity market has been buoyed by more favourable debt markets around the world which have allowed financial sponsors to refinance their debt packages to obtain more advantageous, covenant-light terms, such as debt incurrence covenants only and no loan amortisation or required cash sweeps. This better allows dividend recapitalisations thereby allowing sponsors to potentially realise returns earlier. Lenders are still requiring extensive due diligence on targets, which continues to limit the ability of private equity funds to launch hostile public transactions.

Tim Gordon

GTDT: How has the legal and policy landscape changed during the last few years in your country?

JWN & TG: The only recent high-profile challenge to a private equity investment by the Australian revenue authorities was in relation to the Australian Taxation Office, which sought to tax TPG on its divestment of Myer (a large Australian department store chain) in 2009, and subsequently issued a number of public rulings on their interpretation of how private equity investors should be subject to tax on gains made on their exit. The view of the Australian Taxation Office is that, as a starting premise, gains made by private equity investors on an exit are treated as being of an income character (as opposed to being capital in nature). These positions adopted by the Australian Taxation Office have, however, not dissuaded subsequent private equity investment in Australia.

In relation to corporate regulatory policy, there has relevantly been some ongoing controversy in Australia over the disclosure of confidential, non-binding, incomplete proposals to public targets by would-be suitors. The Australian Securities Exchanged clarified its continuous disclosure regime last year to confirm that there is no legal obligation to disclose such an approach if it remains confidential, however target boards risk being criticised by the media and shareholders if they fail to allow shareholders an opportunity to consider the proposal, if it is subsequently revealed the approach was rejected.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

JWN & TG: Australia is seeing an increase in shareholder activism and is generally seen as a favourable regulatory jurisdiction for activists. For example, in Australia, company directors must arrange a general meeting at the request of members with just 5 per cent of shares, or 100 members (note, however, that the Australian federal government intends to abolish the 100 member rule). Contrast this with, for example, the position in the US where there is no requirement to put materials to shareholders which create a contested board election.

Private equity bidders have used the threat of shareholder activism by implementing a 'bear hug' approach on targets, which involves encouraging large institutional shareholders to exert enough pressure on the boards to engage with their would-be suitors. This strategy was influential in PEP's acquisition of Spotless (which it successfully exited this year).

The prevailing view in Australia is that Australian companies should prepare for increased shareholder activism over the coming years.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

JWN & TG: There have been a large number of exits over the past 12 months with the most notable development being the reopening of the IPO market. 2014 has been the busiest year for IPOs since the global financial crisis (GFC) with a total of 58 floats to date raising nearly A$14 billion. Eleven financial sponsor exits via IPO were announced which represented around 70 per cent of the market.

Due to the lingering effects of the GFC on Australia's capital markets, as well as perceptions around a number of relatively poorly performing private equity backed IPOs in 2010 and 2011, IPOs were not viewed as a likely successful options for private equity exits for a number of years before late 2013. However, market conditions improved in late 2013 and 2014, and to take advantage of this, the structure of sell-down by private equity investors evolved, with escrow arrangements now commonly being structured to allow for a demonstration of the sponsor's ongoing commitment to a successful after-market for the listed company. The re-emergence of dual-track sale processes has also stood out in this regard. This is a popular option for private equity sponsors looking to exit with optimal flexibility (the most notable example being Healthscope) and has been facilitated by the reopening of the IPO market and strong competition for good assets.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

JWN & TG: Top-performing funds are seeing success in fundraising; however, a significant trend that has emerged recently, which is affecting the establishment and subsequent fundraising of PE funds in Australia, has been the flight of domestic capital. In particular, superannuation funds (significant investors in the domestic PE industry) have significantly reduced their allocations from Australian PE funds. Australia's private equity industry association noted that total fundraising for FY2013 was under A$900 million, significantly down from the A$3.3 billion in FY 2012. The impact of this trend is that fundraising remains challenging for local private equity sponsors whose returns have not been in the top quartile, but for those that have performed well, funds are available.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

JWN & TG: Fund formation in Australia can generally be completed in approximately four months (but often takes longer), including determining structure and fund size to the date of first close. There is then typically a second and potentially third close before fundraising is complete. The timeline and documentation for a fundraising can vary significantly depending on the complexity of the offering and whether or not the fund is already formed.

Australian PE funds can be structured as:

- A fixed unit trust – typically managed by a trustee and/or manager with a contractual relationship (trust deed or constitution) between the unitholders and the trustee.
- A managed investment trust (MIT) – a fixed unit trust that satisfies certain characteristics, including having widely held ownership and a substantial portion of the investment management activities carried out in Australia. An MIT may be required to register with the Australian Securities and Investments Commission (ASIC), depending on the nature of the interests offered.
- A venture capital limited partnership (VCLP) or early stage venture capital limited partnership (ESVCLP) – managed by the general partner of the limited partnership, or outsourced to a special purpose investment management entity, and governed by a limited partnership deed. These funds are generally limited to venture capital and mid-market PE funds because of the restrictions on the types of investments VCLPs can make. VCLPs and ESVCLPs established in Australia must be registered as incorporated limited partnerships in a particular state, and as a VCLP or ESVCLP with Innovation Australia.

Determining which fund structure to use can be a significant issue in Australia, as each vehicle triggers unique regulatory obligations (including registration requirements and licensing requirements), taxation treatment and may limit the types of investments the fund can make.

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Australia represents a growing economy with multiple potential exit avenues, which represents attractive dynamics for US and European fund managers. However, owing to these factors there is strong competition in Australia for good assets. Due to the size of our market, deals over A$1 billion are relatively rare. Added to this, the local presence of many of the global funds, such as KKR, Carlyle and TPG, and the interests of global funds out of Asia, such as Bain Capital and TA Associates, results in significant deals being hotly contested and, therefore, fully priced.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Experience, commercial judgement and an understanding of the motivators for private equity (particularly around structuring for future divestments). The Australian market is well served by law firms but those with strong private equity experience tend to be the larger firms with several hundred lawyers. The result is that, because there are only a handful of such firms, lawyers with significant private equity experience tend to be engaged early on in processes so appointing lawyers early is important.

What is the most interesting or unusual matter you have recently worked on, and why?

We recently advised TA Associates and Updata Partners on the successful acquisition of Australian-based software developer Nintex. This deal was interesting as, due to the large number of Nintex shareholders, a regulated Australian takeover bid was required to implement the deal, even though the target was unlisted. While a formal takeover bid is generally less flexible than a private treaty deal, the parties were able to come up with an innovative deal structure that saw the utilisation of a flexible cash and scrip offer as well as the use of unsecured notes, which formed an effective deferred cash consideration portion. The buyers also received strong warranty protection in the context of a regulated takeover.

John Williamson-Noble & Tim Gordon
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GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

JWN & TG: In Australia, there is no specific private equity industry regulator. ASIC is the principal regulator of PE funds.

A domestic PE fund manager will generally be required to apply to ASIC for an Australian financial services licence (AFSL), which sets out the activities the manager is authorised to undertake. International PE funds that do business in Australia may be able to take advantage of licensing relief where they have only limited ties to Australia or where Australia and their home jurisdiction have specific 'passporting' arrangements in place.

Through the AFSL regime, licensees are required to prepare and publicly lodge audited accounts and comply with stringent ASIC requirements relating to compliance and financial resources. ASIC has the right at any time to inspect the books and records of a licensee to monitor compliance.

A domestic fund manager will generally have a head office in Australia and will be structured as a proprietary limited company registered with ASIC (which requires at least one resident director). As stated, an MIT may also be required to register with ASIC.

ASIC's supervision does not significantly impact the day-to-day carrying on of business by a PE fund, however funds should be conscious of ongoing compliance and reporting obligations enforced by ASIC.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

JWN & TG: ASIC now has cooperation agreements in place with 29 EU securities regulators and has signed bilateral memorandums of understanding with each of those regulators, satisfying the first AIFMD condition to Australian fund managers marketing alternative investment funds in the European Union.

Australian fund managers must now comply with enhanced disclosure and transparency requirements, including preparing audited annual reports for each fund they intend to market in the EU, make certain disclosures to investors prior to investing, make ongoing disclosures to investors and report certain information to the regulators of each EU member state in which they market the fund.

Australian PE funds will also likely have to register in the jurisdictions they are marketing to, or satisfy the requirements to rely on an exemption from the requirement to be registered.

EU fund managers are still able to promote their alternative investment funds in Australia, subject to complying with ASIC's requirements for foreign financial service providers.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

JWN & TG: The key tax issues facing private equity investment in Australia relate to the deductibility of interest on acquisition debt, and taxation of investors on an exit. Australia has recently introduced rules to reduce the threshold of allowable gearing from 3:1 debt to equity to 1.5:1. This means that Australian deals may only be funded by, broadly, 60 per cent debt without triggering denial of a portion of interest deductions.

MITs and VCLPs (described above, which are common investment structures for Australian private equity investments) are both typically characterised as flow-through vehicles with income and profits being taxed in the hands of the investors. That being said, there may be withholding tax obligations in respect of profits (ie, distributions and interest) paid through the vehicle to non-resident investors.

The tax treatment of carried interest is dependent on the investment vehicle used by the private equity fund. Broadly, carried interest in an MIT is treated as ordinary income, and thus taxable in the hands of the manager. On the other hand, carried interest in a VCLP is treated as being capital in nature, which may be eligible for discounted capital gains should relevant requirements be met.

Non-resident limited partnership structures are also used, subject to investor profiles and tax residency.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

JWN & TG: Regulatory focus on the industry has been heightened. The recent Australian financial systems inquiry noted that private equity and venture capital firms need to improve their disclosure of fees, which will arguably stimulate competition in the industry. Focus on improving the transparency of fee disclosure is likely to be a recurring theme over the coming year.

The impact on fundraising of the trend of superannuation funds (described above) significantly reducing their allocations from Australian PE funds will also need to be monitored over the next period.

Image: bryantchung\iStock/Thinkstock

PRIVATE EQUITY IN BRAZIL

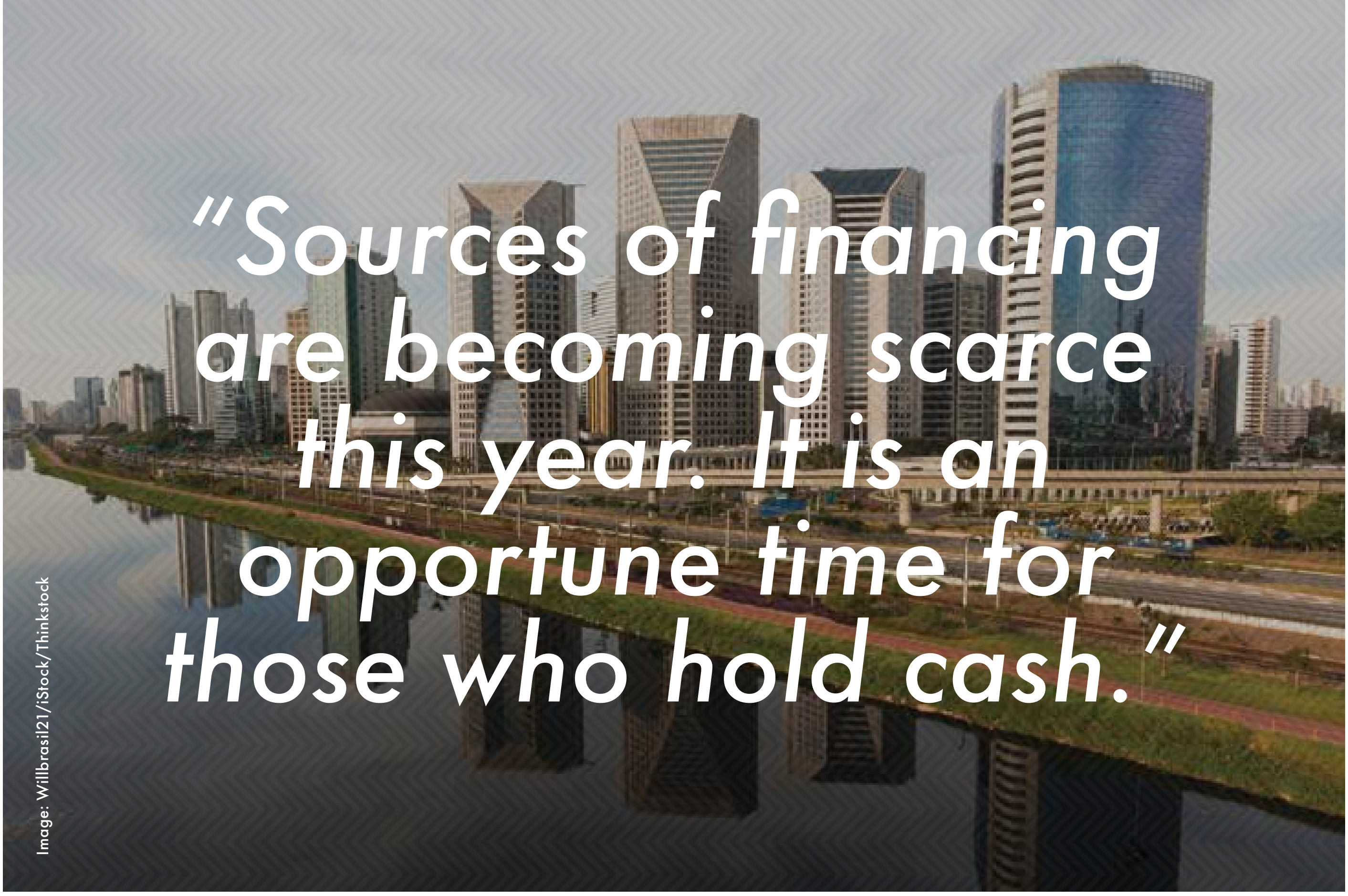
Thiago Sandim is a visiting professor at INSPER and a partner at Demarest Advogados.

Transactions include the US$1.7 billion acquisition of BSI by BTG and the acquisition of 11 per cent of ACECO by GIC in 2014; the acquisition of Construdecor SA by Sodimac/Falabella and the PE investment in Dafiti by OTPP and Santo Domingo in 2013; the IPO of BTG and the 16 billion reais joint venture that won the public bid to build a new terminal at, and operate, GRU Airport in 2012; the acquisition of Celfin and Bolsa Y Renta by BTG and the merger between OHL and Abertis in 2011; the US$1.8 billion investment of the SWFs in BTG SA and the 7 billion reais acquisition of mills from Odebrecht Agroindustrial in 2010.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Thiago Sandim: The fall of the local capital markets (BMF&BOVESPA, the main Brazilian stock exchange, lost around 15 per cent of its value in 2013) made takeovers through the stock exchanges possible and more attractive than earlier in this decade, as the listed assets are cheaper – some even below their net equity value. This resulted in some activity in 2013. For the rest of the year and coming into 2015, however, I do not see this as a very important trend, as despite the large number of IPOs from 2006 to 2008 Brazilian listed companies still have a clear controlling shareholder or a very heavy set of poison pills and shark repellents, or both, which limits buyouts for practical reasons and marks a clear difference between Brazil and the more mature capital markets.

Another very interesting trend from a bird's-eye view is the arrival of big-ticket international PE houses (the likes of KKR, APAX and Carlyle) and sovereign wealth funds in Brazil in the past couple of years. Big-ticket PE houses aim at high-value targets (a good example of that is the acquisition



of ACECO by KKR earlier this year) and look for liquidity within four to five years. Their arrival means that there is confidence in the medium term in profits arising from the Brazilian economy within the economic cycle of these PE funds. The arrival of sovereign wealth funds, which have a longer-term view (since their utmost objective is to protect the savings of the countries that sponsor them), on the other hand, clearly shows that the international community has confidence in the long-term institutions and economic growth of the country, despite the current bad state of the economy (which is growing at a very slow rate and has rising inflation).

The most visible trend in the Brazilian PE market in the past couple of years, however, has been the quick turn into a buyers' market. Sources of finance through the capital markets (which is increasingly selective) or debt (which is increasingly expensive) made the pricing of the Brazilian assets more realistic for PE investments. The long-term trend of stability of the institutions, the large internal consumer market and the confidence in the capital markets bouncing back in the medium term, on the other hand, provide a sense of security to the investors. Finally, global liquidity may improve in the next couple of years, assuming that the economic situation in the US and Europe will continue to get better after the sub-prime crisis. There is also a generic perception that the Brazilian currency is overvalued and will depreciate in the near future. When that happens Brazilian assets will become even cheaper for foreigners with sourcing in foreign currency. Some PE funds have already started buying in the country but the trend of acquisitions by PE funds in Brazil is likely to increase in the coming years as a result of all of the above issues.

Looking at the classic buy-finance-exit cycle of PEs, Brazil, for the legal industry, is in the early stages for some players, while at the very end for others, after investments made around 2010. The bad news for those at the end of the cycle is that we have a capital market that is more on the bear than on the bull side and sources of financing are becoming scarce this year. It is a time of opportunity for those who hold cash.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

TS: All these structures exist in the Brazilian PE market, which is already of a size and shape that allows for different modalities of PE investments. The type of acquisition is hence predominantly dependent on the culture of the PE fund making the investment and the strategy of the target (Brazilian targets very frequently seek minority financial investors). Minority stake acquisitions are certainly the more common type of investment given the corporate culture of the country (which favours large corporations with clear controlling shareholders), but straight buyouts and JVs are also happening.

Hotspots in the last five years were retail, medical services and education. An interesting trend to watch closely, however, will be PE investments in infrastructure. This market is very peculiar as a result of construction risks (at the early stages) and the high level of potential governmental intervention. I think that it will take a little bit longer for the expected investment in this particular industry to materialise. PE investors typically do not like to take construction risks and the number of infrastructure assets in Brazil that are past that stage is limited in terms of type and number. I think that the surge in this industry will occur within two to three years' time, after the assets are built and players have passed the construction risk stage. But I also think that once that stage is over there will be a surge of investments in these types of assets – the return is safe, long term and is guaranteed by institutional stability. It is almost like fixed income. This will be very interesting to see.

Investors coming sooner to that market will make more money. There are certain specialised funds mainly in the UK market that should come and take a look in Brazil. They understand the construction risks and may get into deals more cheaply than those that wait until the end of this phase.

GTDT: What were the recent keynote deals? And what made them stand out?

TS: The keynote deal in Brazilian PE is certainly the investment made by a consortium of high-profile PE funds and family offices in Banco BTG Pactual SA. That is because of the size of the investment (which reached US$1.8 billion, by far the largest in the Brazilian PE market), the profile of the investors (the SWFs of Singapore, China, Abu Dhabi, the Ontario Teachers' Pension Plan, JC Flowers and the family offices of the Agnelli, Rothschild, Motta and Santo Domingo Families), and the speed and success of the exit.

The investment was originally completed in late 2010/early 2011. Members of the consortium joined the board and contributed to the management of the Bank. In 2011 and 2012 a number of high-profile cross-border international acquisitions by BTG were completed (Celfin in Chile, followed by Bolsa y Renta in Chile), bringing the institution to the international markets. Exit of the consortium was initiated in 2012 with an IPO (with a very high average IRR) and continued through block trades throughout 2013 and 2014. The most recent development was the US$1.7 billion acquisition of BSI by BTG, which is likely to cause more than 50 per cent of the income and profits of BTG to be generated out of Brazil.

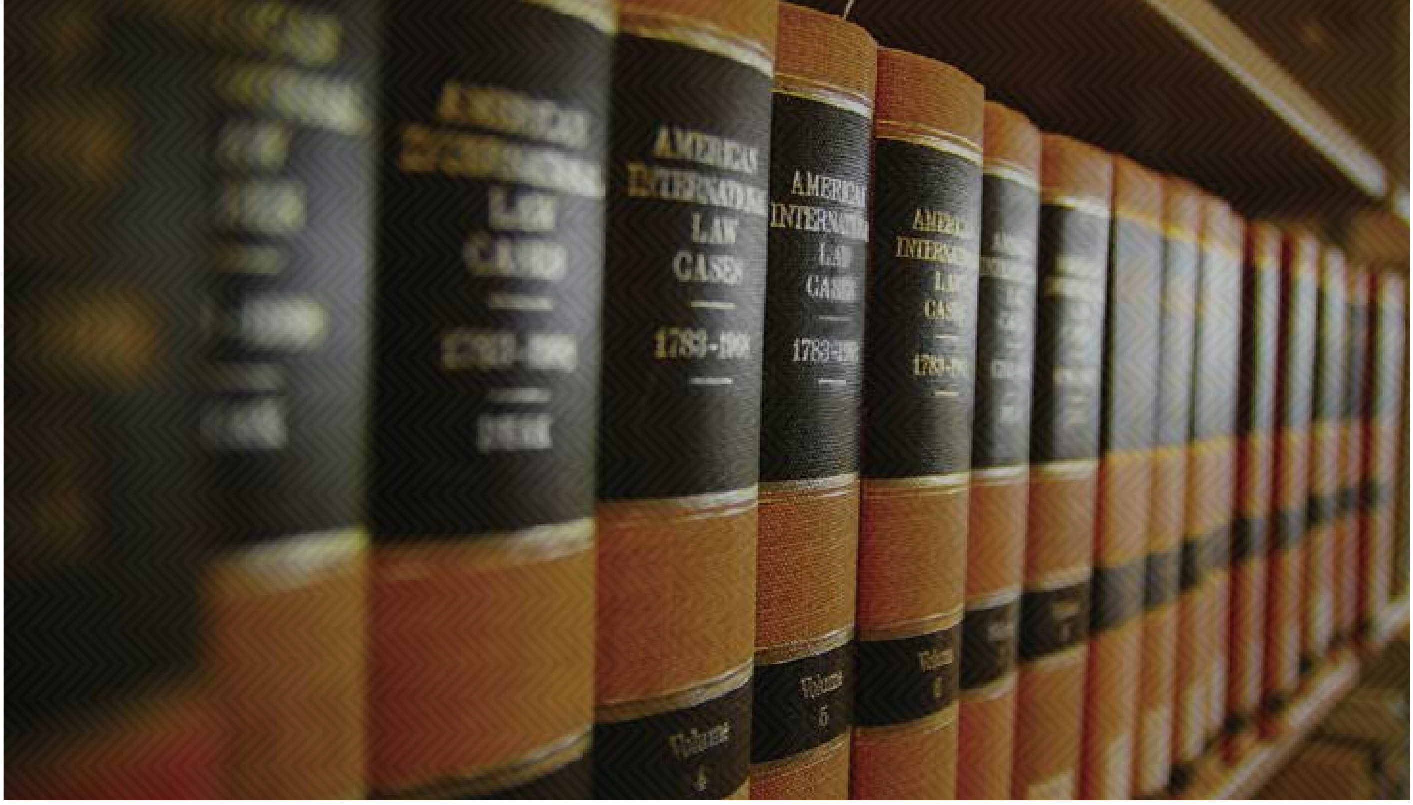
From a legal perspective, the transaction stood out because of its unusual complexity. It may not be defined as a single transaction, but rather as a series of large transactions within a timeline and with the same players. There were predominant elements of Brazilian and New York law and over time from several jurisdictions in Latin America. The business of the bank, including several jurisdictions, had to be contractually stapled during the entire PE term and then a single security had to be created with underlying assets from Brazil and abroad. Today this security trades very well and was used as payment in some of the acquisitions completed by BTG. It is a huge success story.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

TS: Deals do not necessarily need to be cross-border. As to the challenges, these are economic and tax and legal. In the economic field it is important for the PE funds to make use of the potential tax benefits of an investment. The problem with this particular feature is that the more important benefits (those related to income tax on capital gains mostly) are only accessible to shareholders of listed companies, and only in transactions implemented through the stock exchanges. This ties with the type of registry that foreign investors have to maintain with the Central Bank of Brazil. In a nutshell, there are two types of registry – foreign direct investments and portfolio investments. The main challenge is to harmonise the mechanics of the investment with the registries of the central bank, so that the client can benefit from several tax benefits. I think that the basic message here is that the FX market in Brazil is free – people may send money into the country and take it back home whenever they please – but freedom must not be taken as tax-free. One has to get the type of investment, its registry and consequences from the beginning, because this may have huge economic consequences. I have seen a large reduction of the IRR in some investments because tax planning was not properly aligned with the type of investment.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

TS: First of all, it is important to understand that the upstream Brazilian PE market is not as developed as the US or UK's – the financing options, be it through equity or debt, are significantly more limited. Having said that, sponsors usually structure Brazilian upstream PE funds (which are regulated by Instruction No. 391 of the Brazilian Securities and Exchange Commission (CVM), through FIPs (*fundos de investimento em participações,* private equity funds) more for tax reasons than for actual



funding efficiency (this type of PE fund enjoys certain tax exemptions which are applicable as long as allocation and management requirements are met at the level of both the fund and the invested companies). I would quote the fact that the FIPs regulation was recently changed by the CVM to allow for such funds to render guarantees (as long as such ability is expressly provided for in the FIPs regulation and, moreover, that the rendering of guarantees is approved by at least two-thirds of the quota holders of the FIP) is an important recent change, that makes this type of fund more aligned with international market practice.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

TS: The regulatory and legal environment for foreign investments in Brazil has been fairly stable for the past 20 years on the aspects that affect the economics of transactions. Two noticeable changes in the past couple of years, however, affected how PE firms approach their acquisitions. The first is on the antitrust side, where the Brazilian regulation followed the global tendency of preliminary approval of transactions. Now, provided that they reach certain thresholds, transactions that cause economic effects in Brazil must be approved by the local antitrust authorities before closing and can only be implemented thereafter. Until fairly recently, deals that had effects in Brazil had to be notified to the authorities before they were notified in other jurisdictions, but could be implemented before their approval. Secondly, and importantly for local PE business, was the alignment of Brazilian GAAP and IFRS. Put simply, such approach caused the goodwill arising from acquisitions to be reduced (as a result of the methodology of calculation of IFRS). This affects local transactions unlike other jurisdictions, as in Brazil the goodwill is deductible, which increases the tax efficiency of certain transactions. This feature very frequently appeared in the IRR of PE funds, hence its importance.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

TS: Policymakers and the public do not pay specific attention to private equity. There has been no resistance whatsoever to PE buyouts by target boards or shareholders in the past. Nor does shareholder activism play an important role in the country (although there has been some activism in relation to some of the Brazilian flagship companies). In terms of business environment Brazil is generally favourable to PE investments.

> *"An interesting trend to watch closely will be PE investments in infrastructure."*

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

TS: Exit activity was intense until mid-2008 but has been relatively quiet ever since, as liquidity in the local stock markets dried up. A noticeable exception during this period was the exit of part of the SWFs and family offices after the BTG Pactual landmark transaction of 2011. These exits were very successful through the IPO in 2012 and later, in 2013, through successful block trades in the local stock exchanges. In terms of pure PE exits, it is very common to see block trades used as the main type of structure (even in recently IPO'd companies). This is because Brazilian tax law treats block trade exits more beneficially when compared with shares sold in the context of an IPO.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

TS: Levels for funding in the Brazilian markets are low in comparison with the last few years and, from my perspective, the market currently favours investors for a number of reasons, among which I would mention two. The first is the economic

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Tax issues are important, but I would cite exit mechanisms and, on PIPEs (private investments on public equity), the need to verify not only the regulations, but also the by-laws of the target company. On exit mechanisms, the Brazilian capital market is not as developed as the US's or UK's so using it as one's sole exit strategy may prove difficult not only for contractual/legal issues (listing rights are common, but rarely tested) but also because of the huge volatility of the market (which drains liquidity and hence the ability to realise the investment for long periods). It is therefore very important to build an alternative exit scenario and the instruments to implement it. I have seen, for example, put options against the original sellers or syndicate rights (that are usually exercised right after an acquisition). Block trades following the IPOs are also used more frequently than in other jurisdictions because of tax advantages.

An issue of specific import to PIPEs is the wide and disorganised existence of poison pills in the by-laws of Brazilian companies, which aim at making a takeover or even the acquisition of relevant minority stakes much more expensive. The mere reading of these clauses is often misleading as the Brazilian Securities Commission already disregarded a large part of such provisions, so one must be very careful when analysing the effects of a transaction in its early stages. The explanation for the increase in use of these clauses is the boom of the IPOs around 2007, which was widely irrational – leading some companies to build excessively complicated corporate governance structures and unrealistic poison pills. In my personal opinion, the standard Brazilian poison pill, as introduced in by-laws around 2007 (note that I am speaking in general terms here) are an amazing example of a failed attempt of using a protection build to very liquid and different capital markets (in this case, the UK's and US's) locally, which very frequently backfired soon after their introduction because of the credit crunch and the capital markets crisis that followed it.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Your counsel must have a strong tax planning capacity and a very good understanding of the Brazilian regulatory environment, especially with regard to the central bank system of registration and its interaction with tax law, as this may make a big difference in the economic results of a transaction. I would also add experience and track record to this list. Exit structures and scenarios are particularly challenging as a result of corporate governance (as mentioned above, mostly created during an excessively liquidity of the capital markets and hence unrealistic) and complex laws/regulations.

What is the most interesting or unusual matter you have recently worked on, and why?

The most interesting PE investment is, by far, the BTG Pactual case (*see keynote deals above*). However, we are currently working on PIPEs. There are very interesting regulatory challenges (resulting from the limits on foreigners holding equity in certain Brazilian markets) and also capital markets/corporate related issues. The challenging part of this transaction is to harmonise the intention of my client – which wishes to acquire as big a piece of the target as possible – with the applicable regulatory and corporate governance provisions. The good news is that after consultation with some of the authorities the flexibility and willingness of the Brazilian government with regard to its interpretation of certain rules, in an effort to attract foreign investment, became clear.

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situation of the country. The level of governmental intervention raised several eyebrows in the business community and the natural consequence is for investors to hold their money back or invest it in jurisdictions that are considered safer. I personally think that this is an overreaction on the part of the market. The macroeconomic of the country continues to be strong and there is a learning curve at the federal level of the government towards market practices in some important industries (for example, infrastructure). The second is the increase of the interest rates paid by the government. In truth investments compete with each other and the global funds destined to Brazil are frequently driven by jurisdiction rather than type of investment. So it is natural that with high fixed-income rates paid by the government significant capital migrates from more risky investments (such as PE and VC) to fixed income.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

TS: Upstream PE funds are frequently raised abroad for investment in Brazil. As mentioned above, the PE funds raised locally are driven more by tax efficiency (in light of some applicable tax exemptions) than by local liquidity. Having said that, the level of participation of investors in the funds, its corporate governance and the rules applicable to conflicts of interest are among those more intensely debated.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

TS: Regulation is more targeted on the type of fund than the sponsors in Brazil. The main regulation is Instruction No. 391 of the CVM. This regulation, combined with tax rules, allows for advantages (mainly regarding the income tax on capital gains). Supervision of FIPs is performed by the CVM and is intense but focuses on form rather than substance (although this is changing fast). Brazilians usually pay more attention to tax to ensure that they comply with all issues that make them eligible for the tax advantages.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

TS: In truth, upstream PE and fundraising activities are very limited if not non-existent in the Brazilian markets. There are therefore no practical effects for the time being, but the local PE funds are looking at the AIFMD regulations and willing to adapt their business, organisational structures, remuneration policies, etc to comply with the AIFMD. This move essentially derives from the fact that the Brazilian business environment usually follows the European and US standards shortly after they are adopted in an effort to keep the Brazilian market standards in line with the best US and European systems to attract investors.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

TS: The most important tax issues that affect PE investments in Brazil are those deriving from the type of foreign capital registration that the PE takes in Brazil. In a nutshell, there is a difference in the treatment of foreign direct investments made under Law 4131 (which is the oldest Brazilian regime – 'direct investments') and foreign investments made under Regulation 2689 of the Brazilian Central Bank (which is a more modern type of registration – 'portfolio investments'). Portfolio investments may enjoy a favourable income tax on capital gains treatment. The problem is that, in general, such beneficial treatment only applies if the equity is acquired and sold through the capital markets. It is possible to migrate a direct investment into a portfolio investment through several corporate acts and capital markets registrations and de-registrations. The mechanics around this migration are, however, very complicated and may lead to tax impacts in itself. There are no signs of this specific treatment changing.

Another issue of importance is the ability that buyers have to amortise the goodwill arising from acquisitions. This particular tax feature, however, unlike the benefits arising from a portfolio investment, is under intense scrutiny from the Brazilian government and changes were introduced in late 2013. The calculation of the size of the goodwill, for example, was changed to make it more along the lines of the IFRS, which in essence reduced the size of the goodwill. The Brazilian tax authorities are also taking a close look at the economic substance of the goodwill when it starts to be amortised by Brazilian companies. It is very important, when tax planning is being undertaking, to ensure that the entities used to generate the goodwill have more substance and purpose than merely the creation of the goodwill.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

TS: We had a very interesting decade in Brazil for private equity. Since the mid-90s the country has enjoyed institutional and economic stability, which brought the first foreign PE funds to the country and stimulated the upstream investment abroad into Brazilian-managed PE funds. The problem at that stage was the very long cycle from investment to exit. I remember working on the PE investment of one of the big US PE houses of the mid-90s – it was maybe the first time I ever learned what a 'listing right' was. Well, it took more than 10 years for that PE fund to realise the investment (from investment through the IPO exit). Most certainly not a very attractive scenario in a market that has a significantly smaller life span.

In the second half of the 2000s the government, through the Securities Commission, and the local stock exchanges, changed some capital markets rules for the better, introducing higher corporate governance levels (through the *novo mercado* rules of the BMF&BOVESPA) and some clearer tax advantages for foreign investors (through the 2,689 regulations). Those measures, coupled with the international liquidity at that time, boosted the local capital markets to unprecedented levels in terms of both IPOs and trading volumes. The sub-prime crisis of 2008 and the subsequent credit crunch brought the market back to reality, but it was already at a different level in terms of liquidity and sophistication.

I like to illustrate this last part of the interview with the above outline because, to me, this is a time of opportunity in Brazil for downstream PE activity. Companies do not have the irrationality of an excessively liquid capital market working in favour of high pricing and the sources of funding through debt are scarce and to some extent expensive. Some Brazilian companies acting in strategic and promising markets will be economically strangled.

For PE funds, on the other hand, Brazil has a stable institutional environment with a sizeable and reasonably liquid capital market. It is just a matter of time before it bounces back. In other words, there are cheap assets that may in the medium term become liquid through the stock exchanges. I do not think that there will be very relevant changes in the legal environment for downstream PE.

My take is that this is a buyer's market and it is likely to be a buyer's market for the next couple of years.

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PRIVATE EQUITY IN CANADA

Jamie Koumanakos practises Canadian corporate and securities law with a focus on domestic and cross-border M&A and private equity transactions. Jamie acts for international and Canadian private equity funds with respect to private and public acquisition and investment transactions in Canada and advises sponsors and some of the largest Canadian and US pension plans in the structuring and negotiation of private equity fund formation investment and co-investment transactions.

Jamie has recently led the Blakes team advising American Securities in a number of Canadian transactions, including its US$860 million sale of General Chemical Corporation to Chemtrade Logistics Income Fund and advised Hub International Inc and certain of its significant management shareholders in connection with its C$4.4-billion sale by Apax Partners to Hellman & Friedman.

Michael Gans's practice focuses on international as well as domestic M&A transactions. He frequently acts for private equity and other investment funds on cross-border public and private leveraged M&A transactions. Michael also advises on capital markets transactions for participants in the Canadian utilities, telecommunications, internet and technology, transportation, financial services and manufacturing sectors.

Michael has recently led the Blakes teams advising KSL Capital in connection with its acquisition of 24 per cent of Whistler-Blackcomb Holdings, advising Morgan Stanley Global Private Equity in connection with its acquisition of Access Cash General Partnership and advising Ply Gem, Inc, a portfolio company of CI Capital, in connection with its acquisition of Gienow WinDoors and Mitten Inc.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Jamie Koumanakos & Michael Gans: After a moderate 2013, overall Canadian private equity buyout and investment activity has been strong in the first half of this year, with aggregate value and volume reportedly up by 172 per cent and 6 per cent, respectively, compared with the same period in 2013. Similarly to the US, higher stock market valuations in certain sectors have had an impact on private equity transaction activity in Canada, with sponsors weary of overpaying for portfolio companies in broad auction processes. However, with availability of debt capital, from both US and Canadian sources, remaining high and on favourable terms, and relatively low commodity prices, pricing expectations may have been reset in the resource sector. Interest in Canadian investment opportunities remains high, with a few large sponsors dedicating greater resources to the Canadian market, including assigning coverage teams and opening Canadian offices. Sponsors continue to focus on the middle market, which remains the heart of buyout activity in Canada, having accounted for a reported 64 per cent and 38 per cent of buyouts in 2013 and the first half of 2014, respectively.

Canadian public-to-private buyout deal terms continue to parallel the US market in many respects. However, some notable market differences exist, including in deal protection provisions. As highlighted in the inaugural 2013 American Bar Association Canadian Public Target M&A Deal Points Study, in Canada a target board's ability to change its recommendation in support of an agreed acquisition transaction is generally limited to circumstances in which there is a bona fide 'superior proposal' by a third party (65 per cent of transactions surveyed) as compared to a minority of US transactions (only 22 per cent of US deals reviewed in the corresponding US deal points study). Interestingly, while almost half of the US deals surveyed also contained a board right to change its recommendation for an 'intervening event', generally being a material development or change in circumstances occurring after the date of the acquisition agreement, no Canadian transactions surveyed included this provision.

In terms of break fees, a majority of Canadian deals reviewed provided that a wilful or material breach of representations, warranties or covenants by a target would trigger payment of a break fee (65 per cent of transactions surveyed) as compared to a relatively small number of US deals (5 per cent of transactions surveyed). Conversely, reverse break fees payable by the buyer in the event of a similar breach were present in 35 per cent of the Canadian deals in which reverse break fees were otherwise payable as compared to only 9 per cent of US deals. In addition, according to the study, reverse break fees payable by the buyer for failure to obtain acquisition financing were more common in the Canadian deals surveyed compared with the US transactions reviewed (56 per cent of Canadian deals compared with 7 per cent of US deals).

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

JK & MG: Buyouts remain the highest volume sector in the Canadian private equity market, having accounted for a reported 86 per cent of all transactions in 2013. Follow-on acquisitions and portfolio company business expansions in Canada have been prevalent, with sponsors looking to opportunistically maximise portfolio company profitability prior to exit. For a variety of reasons, including the high costs of compliance with corporate governance rules, burdensome related-party transaction rules and (sometimes) limited liquidity of Canadian public markets, public-to-private transactions have become increasingly common in Canada. Buyouts are typically completed through either a one-step plan of arrangement or amalgamation transaction, where the target is merged with a wholly-owned subsidiary of the buyer, or a two-step process involving a takeover bid, followed by an amalgamation or other squeeze-out transaction. Under Canadian corporate law, amalgamations, arrangements and other forms of going-private transactions typically require shareholder approval of 66⅔ per cent of the votes cast at a shareholders' meeting.

Minority equity investments by sponsors have recently trended upwards in Canada as well, representing a reported 14 per cent of all private equity deals in Canada last year and 18 per cent of transactions in the first half of 2014. Such investments in Canadian companies are most commonly made through convertible preferred shares, or subordinated debt convertible into common shares, and often accompanied by warrants to acquire common shares. Convertible preferred shares offer numerous advantages, including priority on liquidation or sale, preferred return, preferential voting or consent rights on material matters, and convertibility which facilitates liquidation transactions. Subordinated debt convertible into common shares also offers these advantages, with the additional potential benefit of security on the assets of the investee corporation. Highly negotiated shareholders' agreements are common in connection with these investments and would typically include the right of the investor to designate a certain number of directors to serve on the target board and to veto certain fundamental change transactions (for example, acquisitions and dispositions of material assets, divergences from an annual approved capital budget or new borrowing arrangements).

In terms of hot sectors, oil and gas transactions led all private equity investments last year, representing a reported 23 per cent of all deals, and this activity appears to be continuing in 2014 with 15 announced deals in the first half of 2014. Perceiving an opportunity to invest at reduced valuations, sponsors have increasingly looked to Canada's energy sector for acquisitions or investments, including in related service sectors. In addition, while private equity funds have traditionally avoided mining investments due to high valuations, commodity price risk and volatility in earnings and cash flows, a number of Canadian and international sponsors have become increasingly focused in the sector, including with the raising of dedicated funds and new asset allocations in existing funds. Last year, mining was the second-largest sector for deployment of private equity capital in Canada, and this interest appears to be continuing thus far this year, including in distressed mining investments.

GTDT: What were the recent keynote deals? And what made them stand out?

JK & MG: Significant Canadian private equity transactions over the last year have included the C$1.22 billion acquisition by Borealis Infrastructure and LifeLabs Medical Laboratory Services of CML Healthcare, Inc; the joint C$1.48 billion acquisition by Alberta Investment Management Corporation and the Ontario Municipal Employees System of Vue Entertainment; Ontario Teachers' Pension Plan's financing of the Hudson's Bay Company in connection with the US$2.9-billion acquisition of Saks Incorporated; and the US$6 billion acquisition by Canada Pension Plan Investment Board and Ares Management, LP of Neiman Marcus. These transactions are representative of the strength of Canada's pension plans which have remained extremely active investors in Canada and abroad. These plans have continued broad investment platforms in a wide range of sectors, including energy, infrastructure and real estate. Pension plan investors have again been involved in many of the biggest Canadian private equity deals in the first half of 2014, representing a reported 22 per cent of all transactions.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

JK & MG: A significant amount of private equity M&A in Canada is cross-border, with either inbound investment or acquisitions by US and international sponsors or outbound activity by Canadian pension plans and sponsors. In 2013, a reported 65 per cent of all private equity investments were cross-border. In cross-border transactions, seamless coordination among relevant jurisdictions (often in conjunction with US or international legal counsel to the sponsor) and early identification of threshold transaction issues is important in order to ensure successful transaction execution. Among others, typical key issues in cross-border transactions include navigating applicable Canadian securities requirements for public company acquisitions, analysis of potential Canadian regulatory considerations (including, Investment Canada Act, Competition Act or other industry-specific hurdles) and cross-border acquisition structuring issues.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

JK & MG: The Canadian lending market remains crowded, with a significant amount of institutional capital chasing too few deals. As a result, private equity sponsors are typically finding many willing suitors for their financing needs and the prospect of 'reverse flex' is now being raised on some deals.

'Xerox' provisions are beginning to be required by lenders in Canadian purchase agreements, although Canadian institutions still do not have the same sensitivity on the point as those in the US Similarly, 'SunGard' provisions have now gained general acceptance in Canada, to the point of even being included in strategic acquisition financings. While some sponsors are again requesting equity cures, they generally remain strongly resisted by banks in Canada.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

JK & MG: There have been a number of recent Canadian tax-related developments that affect potential private equity transactions, in particular for foreign-based sponsors.

In 2012, the Canadian federal government introduced 'foreign affiliate dumping' (FAD) rules to deter foreign-corporate controlled Canadian companies from investing in non-Canadian subsidiaries. While the FAD rules appear to be primarily targeted at foreign multinational companies, they can apply to foreign-based private equity funds holding Canadian portfolio companies with non-Canadian subsidiaries, making it tax-inefficient to use Canadian profits or borrowing capacity to invest in the subsidiaries. Investments in the non-Canadian subsidiaries may have to be made around Canada, which can be cumbersome and impractical for PE funds from a financing perspective.

One tool available to foreign acquirers (including private equity funds) looking to extract non-Canadian subsidiaries out of Canadian corporate solutions at the time of a portfolio acquisition is the basis bump. The bump allows for a step-up in tax cost of non-depreciable capital property (including shares of subsidiaries), effectively to fair market value at the time of acquisition. The bump, if available, facilitates the distribution from Canada of foreign subsidiaries in a tax-efficient manner, which is an important planning tool when faced with the possible application otherwise of the FAD rules. A powerful anti-abuse rule guards the bump. This 'bump denial rule' has in the past interfered with the availability of a bump due to relatively benign elements of transactions. Recent favourable amendments to the bump denial rule have helped to eliminate much of the uncertainty in this regard, making the bump more accessible in appropriate circumstances.

In February 2014, the Canadian federal government introduced proposals aimed at addressing what it perceived to be a trend of abusive 'treaty shopping'; that is, where a non-resident who is not entitled to treaty benefits of a tax treaty with Canada seeks to obtain tax treaty benefits by using an entity resident in a third country with which Canada has a tax treaty to earn income in Canada. While the proposals are at this stage just an outline of what the government is considering, they appear to be quite broad and could potentially adversely apply to foreign private equity funds that hold their Canadian portfolio companies through non-Canadian holding companies. Any rule would not be effective until the tax year after the year of enactment, and it is not clear whether existing structures will be grandfathered. It is interesting that Canada chose to release treaty shopping proposals ahead of the OECD's report on base erosion and profit shifting (BEPS) (expected to be released this September), as we understand that Canada is quite involved in the BEPS project.

"The Canadian lending market remains crowded, with institutional capital chasing too few deals."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Among unique aspects of Canadian private equity transactions, navigating the Canadian securities and corporate law regimes in the public-to-private buyout context can be unfamiliar territory for international sponsor clients. Canadian securities rules may require additional procedural safeguards with certain going-private transactions such as the requirement to obtain an independently prepared valuation of the target's securities, 'majority of the minority' shareholder approval and supplementary disclosure to shareholders. Canadian corporate law provides certain incremental safeguards for minority shareholders, including the right to dissent from fundamental corporate changes and to have shares purchased at 'fair value', which may differ from the offer price.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Given the size, scope and diversity of the Canadian marketplace, any international buyer of Canadian assets retaining Canadian counsel should be seeking depth of private equity investment expertise across all key Canadian jurisdictions as well as the ability to seamlessly manage multi-disciplinary cross-Canada teams. Expert Canadian tax and regulatory advice is a second critical component of any complex Canadian private equity transaction, particularly in cross-border structuring for international sponsors and given the frequency with which Canadian corporations have sizeable international operations. Finally, leading debt finance experience, encompassing the required legal and market knowledge and deep connections across the Canadian lender community, is increasingly critical to the successful execution of private equity investments in Canada.

What is the most interesting or unusual matter you have recently worked on, and why?

Recent interesting matters have included the US$4.4 billion sale of Hub International Inc by Apax Partners to Hellman & Friedman and Clayton Dubilier & Rice's creation of a joint venture with Harsco Corporation including the assets of Brand Energy. Both transactions were notable given the participation of sophisticated private equity sponsors on both the buy and the sell sides.

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GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

JK & MG: Unlike some other jurisdictions, Canada has not seen a great deal of publicised government or public negative sentiment and resistance to private equity investment.

Activist shareholders continue to agitate and wage proxy contests to effect changes in Canadian public companies, exerting substantial influence over board composition, corporate management, strategy and operations. In 2013, JANA Partners lost its bid to elect five directors to the Agrium board following a lengthy and well-publicised proxy contest, while Talisman Energy and shareholder Carl Icahn reached an agreement whereby two of Icahn's representatives were appointed to the Talisman board.

Dissidents have a number of tools at their disposal that can raise serious challenges for public companies, regardless of size. Investors continue to leverage Canada's relatively liberal corporate laws, which permit shareholders holding 5 per cent of the votes to call special meetings and seek to replace directors. Despite a mixed track record, we expect activist investors to continue to see Canadian issuers as potential targets for governance improvements and value maximisation. The proposed reduction of the early warning disclosure threshold and associated enhanced disclosure requirements should provide issuers with better insight into when an activist has acquired an influential stake and its intentions for the company.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently and why?

JK & MG: In the first half of 2014, there has been a reported 61 per cent increase in private equity exits compared with the same period last year. The most common form of exit from Canadian portfolio investments remains a trade sale. While value may be less than could be received on an IPO in favourable market conditions, the generally shorter time frame, limited securities regulatory compliance requirements and greater deal certainty frequently favour a trade sale. Equity capital raising remains relatively challenging in Canada, and initial public offering activity has not rebounded as strongly as in the US, leaving sponsor acquisitions as a favoured alternative for strategic, financial and family-owned or controlled dispositions.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

JK & MG*:* Following a strong 2013 with a reported US$1.9 billion of new fund commitments, Canadian fundraising levels have remained high in the first half of 2014 with a reported total of US$4.8 billion raised, representing a reported increase of 153 per cent over the same period last year. Coming off of a number of challenging fundraising years for sponsors in Canada, the market and terms for investments in funds with established sponsors with strong track records is competitive and increasingly sponsor-driven, while newer funds have, in some cases, been making more investor accommodations on fees and other key terms to reach a first close.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

JK & MG*:* Fundraising in the Canadian market parallels the US in many respects in terms of timing, structure and key issues. Fundraising typically begins with the provision of an offering memorandum to prospective investors and is followed by the negotiation of key fund documentation (eg, fund agreement, side letters and subscription documents). Depending on the track record and investment thesis of the sponsor group, the fundraising process can take as little as a few months but generally runs over a year. Canadian funds are typically formed as limited partnerships, managed by an affiliate of the fund sponsor. In addition to governance and limited partner remedies, the key issue for investors remains fund economic terms. A sponsor's affiliate is generally entitled to a management fee (usually 1 to 2 per cent calculated on committed capital during the investment period and invested capital thereafter) and a carried interest of 20 per cent payable out of the net income of the fund after limited partners have received a return of their contributed capital plus preferred return (usually 8 per cent).

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

JK & MG*:* In addition to applicable Canadian securities law requirements in respect of the offering and sale of securities in Canada by private equity sponsors, Canadian securities laws also regulate entities who are engaged (or hold themselves out to be) in the business of trading securities or advising others regarding the purchase or sale of securities and those who direct an investment fund's business. Canadian securities regulators have provided guidance suggesting that, in many cases, private equity and venture capital funds will not be required to register pursuant to the more onerous investment fund manager, dealer or adviser registration requirements. The guidance suggests that the investing by private equity funds is distinguished from other forms of investing by the role played by the fund managers, including, among others matters, raising money from 'accredited investors' on a private placement basis with the agreement that the money will remain invested for a period of time; using the money to invest in securities of private companies; becoming actively involved in the management of the investment, often over several years (including, for example, representation on the board of directors, direct involvement in the appointment of managers and a say in material management decisions); seeking to realise on investments through a public offering or business sale, at which point, the investors' money can be returned together with any profit; providing expertise relied on by the investors for the selection and management of the investment; and receiving a management fee or 'carried interest' in the profits gained from the investments in return for their expertise with no compensation for raising capital or trading in securities.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

JK & MG*:* While the AIFMD is a European directive and is not applicable in Canada, certain Canadian sponsors have been affected by the need to consider its application when engaging in fundraising activities outside Canada. Canadian securities regulators are in the process of revising investment fund regulation rules. Starting with conventional mutual funds and closed end funds, with certain revised rules in this regard coming into effect on 22 September 2014, further rules for conventional closed end funds are still being considered, and the final phase of this project will involve the development of a set of rules for alternative or non-conventional investment funds such as private equity funds. The direction the Canadian securities regulators intend to go with alternative fund rules is not known.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

JK & MG: The major tax issues facing foreign private equity funds investing in Canada have already been discussed. Interested parties should keep a close eye on the development of the Canadian federal government's treaty shopping proposals as well as the OECD BEPS materials as the year progresses.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

JK & MG: As discussed, we expect to see continued strong interest in Canadian private equity investments from US and international sponsors for the remainder of the year. With a sustained focus on the middle market, particularly in the energy and resource sectors, we expect sponsors to continue viewing Canada as a favourable and economically stable jurisdiction for buyouts and investments.

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Betty Yap

PRIVATE EQUITY IN CHINA

Betty Yap is a partner at Linklaters, where she advises on cross-border private equity deals in China and Asia.

The firm's track record includes recent transactions such as advising the Carlyle Group in connection with the US$1.62 billion voluntary general offer for Yashili by China Mengniu International Company; Noble Group on the disposal of 51 per cent of its agricultural business to a consortium comprising HOPU, COFCO and other institutional investors, and on the formation of a joint venture and the lead arrangers on the US$1.3 billion leveraged term facility and subordinated limited recourse vendor loan note to finance the leveraged buyout of Giant Interactive Group by a consortium led by Baring Private Equity Asia and Hony Capital.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Betty Yap: In the last year or so, we have seen a pick-up in the level of inbound private equity investment into China by international private equity investors after a period of comparative lull as the market awaited the leadership change and any resultant shift in government policies.

Deal size tends to be mid-market, partly because foreign ownership restrictions in some regulated industries continue to make buyout deals in those industries challenging (other than for PRC holdco leveraged buyouts and take-privates, as discussed later), partly because Chinese state-owned enterprises and private businesses controlled by Chinese entrepreneurs are reluctant to sell out completely or cede control for political and commercial reasons, and partly because there is not yet a mature market of professional management teams in the local market to support buyout transactions.

The competition for deals is becoming more intense as international private equity funds compete with domestic funds and international and

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domestic strategic investors for limited investment opportunities in China, where valuations remain strong.

We are seeing more large-scale transactions by way of outbound investments by Chinese private equity funds. One example is the recently announced £900 million buyout of PizzaExpress by Hony Capital from Gondola Group in the UK.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

BY: We are seeing a proliferation of different types of investment, including buyout deals (such as the Carlyle-led consortium's buyout of Focus Media), minority deals, pre-IPO investments, PIPEs (private investment in public equity) (such as Haier's convertible bond issue to Carlyle) and take-privates.

There have been a few notable developments in terms of deal types. We have seen early signs of a trend of Chinese strategic investors investing alongside private equity funds, partly to raise additional liquidity and syndicate risks and partly to benefit from their deal execution capabilities. Examples include the co-investment by Sany Heavy Industry and CITIC Private Equity of Putweiser in Germany in 2012 and the US$1.5 billion joint acquisition by COFCO and Hopu for a 51 per cent stake in the global agricultural businesses of Noble Group and COFCO's acquisition of 51 per cent of Nidera, both announced earlier this year. We're also seeing pension funds and other key limited partners increasingly executing co-investment deals with their private equity sponsors.

In regulated industries in China where private equity investors do not qualify to make direct investments, some private equity investors have opted to take a derivative position in order to gain exposure to the economics where they are not able to obtain control over the voting rights or have access to the underlying shares. There is an increasing repertoire of structured investments available to private equity investors in these situations.

There are early signs that portfolio companies are starting to be active in bolt-on acquisitions. An example is the US$4.7 billion acquisition of Smithfield Foods by private equity controlled WH Group (previously Shuanghui International Holdings). That is, however, a somewhat unusual situation as many portfolio companies are not yet of a scale or at a stage of development where they will be making acquisitions of this size or where they will have international ambitions. However, things are changing and are possibly moving in this direction.

In terms of investment hotspots in China, the focus has continued to be on portfolio companies that ride on Chinese consumer growth, particularly the growth of the Chinese middle class. As such, industries such as financial services, dairy, other foodstuffs, health-care services, education and other online platforms attract much private equity interest.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

BY: There is a fair amount of private equity M&A activity in China that is domestic as local private equity funds proliferate and become active in the market, including the qualified foreign limited partner (QFLP) funds, which are domestic private equity funds established by international sponsors. However, there remains a large portion of private equity M&A activity in China that is cross-border as international private equity funds continue to want to access Chinese opportunities and as large Chinese private equity funds begin to flex their muscles overseas and look to expand their portfolio.

Challenges include addressing a very different legal regime in China from those that international private equity funds may be more familiar with. Some investment features that an international private equity fund would have otherwise sought may require much structuring to implement and some simply cannot be replicated in China. Concepts that often pose challenges include preferential rights attached to shares (preference shares have only been introduced earlier this year in China on a pilot programme for listed companies that make up the SHSE 50 Index), liquidation preference and payment waterfalls.

Foreign investment in China is subject to a multitude of regulatory approvals, including foreign ownership approvals, foreign exchange approvals, and possibly national security review, merger control approvals and industry regulators' approvals. This often results in a protracted timetable and introduces uncertainty into deals that will need to be managed with international private equity investors.

Cross-border private equity investment into China would generally require bilingual deal documentation. This can pose challenges in a tight timetable as producing Chinese and English deal documentation on a parallel and real-time basis is labour- and time-intensive. More importantly, given the difference in syntax, it would be difficult to have identical Chinese and English versions, which could leave open areas for future disputes, particularly if each language version is to have equal force (although increasingly we are seeing that parties agreeing to the Chinese version prevail in order to reduce the scope for potential dispute).

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

BY: Increased market liquidity and risk appetite for China holdco leveraged buyout structures is the current theme. Pricing has been tightening and leverage levels have been increasing for China LBOs, making financing more attractive for private equity sponsors. Chinese banks have joined the Taiwanese and international banks in arranging and underwriting PRC-related LBOs, with Focus Media and Giant Interactive being good examples.

In addition to the well-established PRC take-private structures such as China Fire & Security, 7 Days, AsiaInfo-Linkage, Focus Media and Giant Interactive, there is a new trend of private PRC holdco LBOs such as CVC's buyouts this year of South Beauty and EIC, which are the first such deals since the financial crisis. This presents private equity sponsors with the opportunity to leverage their control buyouts of PRC-based businesses in a manner that has not been available since the end of 2008.

We are also seeing the slow development of 'institutional' tranches in Asian LBOs, including in PRC-related deals. This is a tranche provided by non-bank investors on a pari passu senior secured basis with the senior bank tranche, but with a bullet payment and a higher interest margin. This is attractive to financial sponsors as it puts less pressure on cash flows by reducing the amortising portion of the debt, and may offer additional leverage.

Overall, absent adverse macroeconomic factors, the increased liquidity and risk appetite for China holdco LBOs should mean more opportunities for private equity sponsors to take control stakes in PRC-based businesses, by making it easier to hit target IRR levels, leading to increased deal activity.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

BY: The Hong Kong Stock Exchange has issued and updated the Guidance on Pre-IPO Investments in recent years, setting out its position and guiding principles in relation to which rights and benefits are permitted in pre-IPO investments in companies applying for listing on the HKSE. The guidance also reaffirmed its position in the Interim Guidance it issued in 2010 on requiring pre-IPO investments to be completed and settled at least 28 clear days before submission of the listing application or 180 clear days before the first day of trading of the applicant's securities, making it harder for pre-IPO investors to minimise their risk by investing closer to the listing date when there is more certainty on exit, forcing investors to accept a certain level of genuine risk to justify the discounts and preferential terms that are granted to them over IPO subscribers. This is an attempt by the HKSE to control the extent of gains made by private equity and other pre-IPO investors through discounts to IPO price locked in their investment agreements and to reduce the disparity between the pre-IPO investors investing before IPOs and public investors subscribing to the IPOs.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

BY: Chinese regulators remain sceptical of private equity investment to an extent, with the main concern being that their investment may be speculative and drive up valuations without adding real value to the companies unlike strategic investors. We see this in various regulated industries where Chinese regulators have imposed qualification requirements to be met by foreign investors that are designed to limit investment to qualifying strategic investors and to preclude private equity investors.

There is speculation in the market that there may be some relaxation in the future, with private equity funds being rumoured to be possibly approved to invest in certain regulated industries and with developments including the QFLP programme and the recently amended Securities Investment Fund Law, both of which are recognition in some form of the level and importance of private equity activity in China.

There has been some concern expressed by the public as to the extent of gains made by private equity funds and the resultant unfairness, partly as a result of the backlash against the financial services generally around the world in the wake of the global financial crisis. However, there have not been notable and consistent examples of major opposition by the shareholder base of companies to resist private equity investments, in part because the shareholder base of Chinese companies tend to be concentrated and dominated by their founders, leading to reduced levels of shareholder activism, and partly because shareholders on the whole behave fairly rationally and would look at the benefits that a private equity investment may bring to a company.

One notable example of shareholder reaction to private equity in earlier years was the shareholder opposition at Gome to, and eventual cancellation of, the general mandate for the issue of shares at the board's discretion without first offering to existing shareholders, partly from a belief that the private equity investor with significant board presence could be issued shares out of the general mandate. However, that situation was more often seen as a battle between the company (with private equity funding) and the founder and controlling shareholder, who had been outspoken in their opposition to the general mandate out of their stated desire not to have their shareholding diluted to below 30 per cent and cede control.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common?

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Which exits have caught your eye recently, and why?

BY: Exit by private equity investors in IPOs has not been as realistic as the investors had hoped, primarily because valuations have been somewhat depressed in the public markets and the level of interest from the public markets has also been uncertain. There have been a number of IPOs with private equity monies that have been stalled. For example, the proposed IPO of WH Group (previously Shuanghui) has been stalled and has now been relaunched. There are also a number of other smaller IPOs that faced the same destiny.

There has been an increasing level of exit via trade sale. A notable example was Carlyle's sale of its shares in Yashili as part of the takeover of Yashili by Mengniu.

In the same spirit, we are also seeing more focus by private equity investors in the deal documentation

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Regulatory approvals, foreign ownership restrictions, absence of certain legal concepts taken for granted overseas and the resulting difficulty in implementing certain concepts used in other jurisdictions that private equity funds are otherwise familiar with such as preference shares (in a private company), liquidation preference and earn-out structure.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

1. The ability and experience to give an informed risk assessment and help the client make the right judgement call in the context of institutional requirements, international practice and local reality.

2. Familiarity with local requirements and market practice combined with the ability to understand and apply international practice and institutional requirements.

3. Infrastructure and scale to deal with large-scale complex transactions spanning multiple practices and product specialties (eg, fund formation, investment expertise, financing capabilities and regulatory expertise).

What is the most interesting or unusual matter you have recently worked on, and why?

We acted for a private equity fund in their participation in an auction bid for a pre-IPO investment into a large Chinese financial institution with a significant portfolio of assets. Given limited timing and information access, the scope of due diligence had to be very targeted such that we could properly analyse the vast assets of the company within the time frame. PRC regulations dictating investor qualification requirements for this industry presented further challenges, requiring us to explore upstream synthetic participation through derivative instruments in the event that our client's application to qualify for direct downstream participation was unsuccessful.

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on drag-along provisions to pave the way for a forced trade sale if needed.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

BY: In response to the Federal Reserve's tapering of quantitative easing, some investors have withdrawn money from emerging markets and back into developed markets. However, the volatility in developed markets and the vast number of potential investments, particularly in its growing consumer sector, will still attract investors to private equity in China.

The reopening of China's IPO market has encouraged investors to return to the Chinese market. Although we have seen greater use of trade sales than was typically practised in China and there is still a long queue of companies waiting for their IPO, this change has reduced previous uncertainty as to the exit strategy for investments.

Institutional investors have held greater negotiating power with funds in recent years but, as more capital is expected to flow into the private equity market, they may now hold less of an advantage.

While funds were reluctant to acquire in the face of low interest rates having encouraged inflated valuations, the resultant larger payouts seen by investors in 2013 has generated improved fundraising efforts for 2014. Sponsors currently hold record levels of dry powder and so, for funds with a proven track record in particular, we see funds holding large war chests and able to continue raising large sums and extending investment periods on existing investments.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

BY: For an international PE investor in China establishing a QFLP fund, the typical process begins with agreeing an MOU with the relevant local government where the fund is to be established. An offering document (PPM) is then sent to potential investors, and term sheet signed with limited partners, and then the documentation for the limited partnership agreement and any side letters with limited partners. Following this, registration of the fund must be made with the relevant branch of the State Administration for Industry and Commerce, and approval obtained from the State Administration of Foreign Exchange for the necessary foreign exchange quota.

There has been a debate in the market as to whether these types of funds, denominated in renminbi with capital raised from PRC investors, would be treated as domestic investors, which would free them from foreign ownership restrictions and approval processes, but the position has not been definitively clarified. In 2012, NDRC ruled against applying domestic status to a QFLP fund (raised exclusively from PRC investors). The PRC Ministry of Commerce has yet to opine on their status.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

BY: Currently, regulations and the position in China are unclear. The recently amended Securities Investment Fund Law has made it clear, however, that the Chinese Securities Regulatory Commission (CSRC) has the power to supervise and regulate private equity funds. Fund managers of private equity funds are required to make filings with the Asset Management Association of China (AMAC), which is authorised by the CSRC to proceed with such filings of private equity funds.

A new draft rule of the CSRC sets out certain criteria on eligible private equity fund investors, which include (among others) a requirement that the minimum investment by an investor in a single private equity fund be not less than 1 million renminbi and the net assets of the investor not less than 1 million renminbi.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

BY: Although the AIFMD is a part of European Union legislation, its impact is being felt by fund managers globally, including within Asia. The fact is if you are establishing a fund that is domiciled within, managed from within or marketed to investors within the European Union you will be subject to the provisions of the AIFMD in one way or another. In practice, this means fund managers are having to consider at an early stage in the fund structuring process the extent to which the AIFMD will affect the way in which they structure, manage and operate their funds.

For managers outside the European Union, it is the rules relating to marketing of fund interests to EU investors that are likely to have the biggest impact. Funds marketed into Europe on a private placement basis are required to be registered with individual member state regulators and to subject themselves to certain ongoing regulatory reporting requirements. In addition, disclosure documents will need to be checked to ensure they satisfy the mandatory disclosure requirements of the AIFMD. In some member states, the act of registration can add significantly to the fundraising timetable. The additional burden of complying with these requirements, as well as the complexity of dealing with varying requirements in different member states means that some managers for whom Europe is not a central part of their fundraising plans are choosing not to market their funds there.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

BY: The main tax issue arises from Circular 698, which seeks to prevent offshore investors from using offshore holding companies to avoid tax on capital gains made with respect to Chinese investments by taxing any offshore company transferring (whether directly or indirectly) the equity of a Chinese onshore company.

Investors buying offshore securities will thus want to seek reimbursement of this tax from sellers, but it is often difficult to negotiate an indemnity or condition precedent to fully protect the buyer on this liability.

The tax treatment of limited partners in a fund in the PRC is currently uncertain regarding the extent of tax liability for carry interest and taxable income and the availability of offsets and tax credits. Tax transparency should see each limited partner taxed based on the amount of taxable income that it is allocated – at 25 per cent for companies and 35 per cent for individuals.

It can also be difficult to utilise preferential withholding tax arrangements under double tax treaties as investment vehicles struggle to establish that they have a substantive presence in another jurisdiction when they simply exist there as a corporate shell.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

BY: We expect to see increased levels of activity in the private equity space, driven in part by private equity participation in state-owned enterprise privatisations, a programme that is expected to be instigated and encouraged by the PRC authorities, as we have seen with the CITIC Group's backdoor listing in Hong Kong and the proposed solicitation of external investment in and ultimate listing of Sinopec's downstream retail unit, and private equity funds will be keen to be involved in these opportunities.

As the situation for exits for private equity investments begins to improve, with an increase in capital markets activity and regulatory approval for IPOs combined with an increasing market for trade sales, we would also anticipate more intense competition as more players become involved – traditional private equity funds, pension funds, special situations investors, hedge funds, sovereign wealth funds, domestic funds – not to mention competing against strategic investors.


Kristian Tokkesdal

PRIVATE EQUITY IN DENMARK

Kristian Tokkesdal is a partner at Delacour Law Firm. He provides advice to Danish and foreign companies within company law matters and in relation to company foundation, funding, formation of ownership agreements and company law documents.

Kristian has experience in the reorganisation of companies and the interaction between company law and tax law rules. He has also assisted in the establishment of private equity funds.

In addition, Kristian has assisted Danish and foreign companies in a large number of M&A transactions on the part of both buyer and seller.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Kristian Tokkesdal: During the global financial crisis private equity firms have in general been operating in an increasingly uncertain environment and activity levels have been fairly low compared to before the crisis. But especially during the second half of 2013 and the first half of 2014 there has been an increase in activity levels. I recently saw a press release from a corporate finance firm stating that the number of private equity deals is expected to rise fourfold in 2014.

In particular, we are now seeing private equity firms having increasingly more focus on investing in mid-market firms and the competition between private equity firms on closing deals with attractive mid-market firms seems to be picking up. We expect that this development will continue in the near future.

On the same token many private equity firms are pursuing different exit routes since the general impression is that the conditions for M&A activities is favourable at the moment.

There is still an undeveloped market for private equity firms in the market for small firms and some private equity firms are trying to develop this market further, primarily by facilitating mergers of smaller companies before or simultaneously to the investment being made by the private equity firm in the consolidated company. But established and bigger private equity firms are still focusing on larger or mid-market firms and the future will show whether there will be a private equity market for smaller firms or not.

The stock market in Denmark has in general been positive and especially the larger companies have seen a significant rise in market value. Also the few IPOs that were made in 2014 have on the whole been fairly successful. We have seen that this has also had a positive effect on the M&A market in general.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

KT: The majority of the private equity firms are still unlikely to pursue minority-stake investments in mid-market transactions. Usually, transactions are structured as straight buyouts or straight buyouts with re-investments from the sellers with non-deciding influence post-transaction. But we have seen some transactions where a number of private equity firms form a consortium which makes the transaction. Typically, such consortiums are used in larger deals and not in mid-market deals.

Expanding markets such as IT and energy have the utmost attention from the majority of the private equity firms due to the growth in revenue and the increasing attention from the government in facilitating investments in these areas.

GTDT: What were the recent keynote deals? And what made them stand out?

KT: In 2014, a consortium fronted by Goldman Sachs made an investment in the state-owned company DONG Energy and obtained a minority stake. The Danish state remains majority shareholder of the company. The transaction gave rise to an intense political debate on whether important utility companies such as DONG Energy could be controlled by private firms instead of by the Danish state.

Another keynote deal in 2014 is the purchase of Nets by Advent International, Bain Capital and ATP. Nets is one of the leading North European providers of digital pay, information and ID solutions. The transaction involved a great number of bidders and had huge public interest because Nets has access to personal data on a great number of individuals and has a monopoly on the market.

Nordic Capital's secondary buyout of Unifeeder from Montagu is also a keynote deal involving a large Danish company which is a market leader with northern Europe's largest feeder and short sea network for container transportation.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

KT: Danish-based private equity firms will typically invest in Danish or Scandinavian companies. But in many cases the exits made by the private equity firms are done as cross-border transactions and therefore a lot of work done by Danish legal advisers in private equity is cross-border.

In general Danish M&A and corporate law is regarded as being very flexible compared to other countries. Danish legal advisers are accustomed to light regulations and have a very pragmatic approach to transactions and investments.

Consequently, Danish legal advisers face challenges in explaining to clients the complexities of the formalities in multi-jurisdictional deals regarding, for example, notarisation and legalisation of transfer documents, governmental registration of the change in share ownership and similar issues. Such formalities are viewed by Danish clients as bringing little value to the deal and as time-consuming and costly.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

KT: The increase in the number of private equity transactions in the last year and the current year is partly driven by the fact that banks are now willing to provide debt financing in a larger scale and with a debt-to-equity rate that is more suitable to private equity firms than during the financial crisis in combination with a low interest rate making it inexpensive to loan. In 2013, approximately 44 per cent of the purchase sums in private equity deals were financed through equity from the private equity firms and others and the rest of the purchase sum was financed through debt. We expect that this debt-to-equity rate may rise even further throughout 2014. So there is no doubt that the availability of debt financing has increased significantly during the last year.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

KT: It is our view that the Scandinavian countries today are seen as attractive for foreigners to invest in due to the stability of the economy and political landscape. Moreover, in Denmark a decrease of the corporate tax to 22 per cent and other incentives have been deployed to attract more investments in Danish companies.

Before the global financial crisis, private equity firms were not subject to specific regulations. However, due to the political landscape in Denmark private equity firms are now facing national and supranational regulations, for example, specific tax laws, the AIFMD, etc.

It is often emphasised that the Danish tax on dividends from smaller possessions of unquoted shares (ownership percentage of less than 10 per cent) is a large disadvantage for the private equity firms' investments compared to our closest neighbours. But, with the right tax planning most of the disadvantages of this tax can be avoided.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

KT: Goldman Sachs' acquisition of shares in DONG Energy and Advent International, Bain Capital and ATP's acquisition of Nets are the few examples of how Danish policymakers and the public express opinions regarding the transaction process and in connection with the announcement of the acquisition, the public opinion rose day by day against the proposed acquisition driven by politicians on all sides of the political parties. However, both transactions were carried through regardless of the protests and today the negative opinions expressed by some politicians and other spokesmen seem to have been forgotten.

However, these are rare examples of transactions giving rise to resistance or public protests in Denmark and in general there is little resistance to private equity buyouts.

So far, shareholder activism has played a very small role in Denmark and does not seem to be a problem for private equity firms. The impact has mostly been in the largest companies with a number of US shareholders where a campaign has been initiated.

Some of the largest financial institutions have announced that they will seek to gain more influence in the companies in which they hold shares. But whether this will lead to campaigns of shareholder activism as seen in the US and UK is uncertain since these financial institutions are very conservative in their approach and behaviour. Moreover, the number of companies in which shareholder activism seems to be relevant is not that great and therefore we do not expect shareholder activism to become a big theme in the near future in Denmark.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

KT: The number of exits from private equity firms has increased throughout 2013 and the activity levels seem to be continuing in 2014. It is also the general opinion that the market for exit is very good at the moment because the financial crisis seems to be over and the terms for debt financing, for example, interest and debt-to-equity rate, are attractive. At the same time there seems to be a lot of money waiting to be invested by corporate investors, financial institutions and private equity firms.

Usually, private equity firms have chosen traditional exit routes such as industrial sales or secondary buyouts. However, IPOs are now being seen as an alternative to the traditional exit routes for the biggest firms. In 2014 shares in OW Bunker, Matas, ISS and TDC were listed on the Copenhagen Stock Exchange as part of a partial exit from private equity firms. It is expected that more IPOs will follow in the coming years. However, IPOs are generally reserved to the largest companies and for mid-market firms an IPO is not an option. However, many initiatives are now being discussed on how to make IPOs more attractive for mid-market firms for this to become an attractive way of exit in the future.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

KT: Between 2006 and 2010 a large amount of fundraising took place. This, in combination with the decrease in transactions completed during the financial crisis, means that many funds had a lot of dry powder in the form of unused committed capital after 2010 – and a number of funds still have. Therefore, fundraising has up to now been fairly low.

But it is expected that fundraising will increase in the near future in line with higher activity levels in the private equity market.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

KT: A typical fundraising in Denmark starts with the fund managers – or the potential fund managers – initiating discussions with primarily financial institutions in order to get a commitment from one or more cornerstone investors in the fund. Such discussions will be based upon an investment memorandum or prospectus outlining the investment strategy for the fund, management and main terms for the limited partnership agreement.

When one or more cornerstone investors have committed themselves to invest in the private equity firm a first closing of the fund is typically held so that the fund can start its activities. Often one or more secondary closings are held afterwards as additional investors commit to participating in the fund. Usually the fund will be finally closed for new investors within approximately 12 months of the first closing.

Image: tracy lorna/iStock/Thinkstock

Private equity firms are formed as either limited liability companies or limited partnerships. However, most private equity firms are formed as limited partnerships primarily due to tax reasons and increased flexibility in respect of allocation and distribution of capital between the investors and the fund.

A limited partnership is formed through a partnership agreement between the limited and general partners. Thus, the partnership arises once the agreement has been executed. There is no minimum capital, apart from a minimum commitment of 1 Danish krone, required for registering a limited partnership. Usually a limited partnership is formed with a low paid-up capital but with a commitment from the investors or limited partners to distribute an agreed additional amount to the limited partnership when called upon by the fund manager.

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Even though private equity practice in Denmark is heavily influenced by the practice and standards of the private equity firms outside the country, the market in Denmark is still quite informal and flexible with a commercial view where 'matters' prevail over 'formalities'. Compared to other jurisdictions this seems to be a unique approach.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

When choosing counsel for a complex transaction in Denmark the following three things are worth considering:

1. Make sure that experienced tax advisers are visited so that the structure of the transaction is decided in the best way to avoid unforeseen taxations of proceeds from the target company and/or from the private equity firm.

2. When approaching a mid-market target company, which in many cases will also be a family-owned company, make sure to consider whether the advisers chosen to assist in the transaction are capable of understanding the stressful and unfamiliar situation the sellers of the target company are in, and are able to provide the necessary level of trust in the negotiations.

3. Make sure that you choose a full-service legal office with the ability and time to attend to all of the legal aspects of a complex transaction: competition law, real estate, employment law etc. Denmark is a small country and experienced M&A lawyers from the top 10 firms are often familiar with each other due to other transactions, which usually benefits the process.

What is the most interesting or unusual matter you have recently worked on, and why?

Currently, I am involved in a proposed transaction in which the seller (my client) shall reinvest a smaller part of the proceeds from the sale of the target company in the buying company. Due to expected losses in other companies within the seller's group, we are pursuing a transfer structure which allows the seller (post-closing) to continue the joint taxation with the target company even though he will have a minority shareholding well below 50 per cent. These discussions and efforts show the flexibility of the private equity firms in connection with making transactions happen.

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A limited partnership shall have both a limited partner and a general partner. The limited partner is not liable for the debt and obligations of the limited partnership in excess of its capital contribution whether such capital is paid-up or committed to be paid up later. The general partner is liable for all of the limited partnership's debt and obligations. Normally a limited liability company will be registered as the general partner and the investors, being one or several entities, each (typically, but not necessarily) with legal personality, are registered as limited partners.

Both a limited partnership and a limited liability company have legal personality and therefore will be separated from the investors with respect to liabilities and may be party to all judicial matters.

As a supplement to the management, the investors will typically elect an advisory board or investment committee who will represent the investors in discussions with the fund manager on certain material issues (eg, investment guidelines, exit).

Normally, the fund managers will establish a management company which will participate as investor in the private equity firm and be entitled to receive the management fee. The management fee is typically made of a fee calculated as 1 to 2 per cent of the invested capital and of a carried interest calculated as a part of the final proceeds of the fund. The carried interest will typically be calculated as approximately 20 per cent of the profit of the fund's investments taking into account interest going to the investors of 8 per cent per annum.

The internal relationship between the investors, fund managers and the private equity fund is regulated by a limited partnership agreement that will contain detailed regulation of a number of issues. Limited partnership agreements for Danish private equity firms will in general be governed by Danish law.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

KT: In general, private equity sponsors are not supervised very heavily in Denmark and it is our impression that this is not an issue in day-to-day business. But we have not seen the full effect of the implementation of the AIFMD and surely this will have an impact on the day-to-day business in the view of the fund managers.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

KT: The Danish Financial Supervisory Authority has currently registered 19 fund managers pursuant to the AIFMD. The implementation of the AIFMD has of course had a lot of attention from the fund managers and legal advisers. But so far, the effects on fundraising seem to have been minimal.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

KT: As most private equity firms are established as limited partnerships, a private equity firm is not generally taxable in Denmark of its income and gains. Under current rules a limited partnership is not a taxable entity and instead it is the partners of the limited partnership that are liable to tax. Accordingly, distributions of funds from the private equity firm to the investors do not in general trigger any tax in Denmark. The investors are instead taxed in their own jurisdiction.

Portfolio companies are typically owned by the private equity firm through a limited liability holding company. The taxable position of the investors is therefore as if the investors own the shares in the limited liability holding company directly and not indirectly through the private equity firm – due to tax transparency of the private equity firm. Therefore, the Danish tax on dividends from smaller possessions of unquoted shares (ownership percentage of less than 10 per cent) is relevant to avoid for the investors. In this respect it should be noted that a withholding tax is implied upon these taxable dividends.

There are certain rules that apply in respect of the taxation of dividends and capital gains or losses received by some of the investors in private equity firms (rules on carried interest). Investors in private equity firms who have been given a preferential position in the private equity firm (due to the construction of the private equity firm) shall include dividends and capital gain or losses in their personal income. A preferential position is considered to be given if the proportionate profit, dividend or capital gain received by the investor exceeds his or her proportionate shareholding or loan provided to the private equity firm. Therefore, this taxation will typically only apply to the private equity firm's manager. The rules on carried interest are based on the assumption that a dividend or gain in excess of a standard return on the shareholding shall be considered a bonus or consideration to the investor for his or her successful establishment, business and divestment of the private equity firm.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

KT: Looking ahead, I expect we will still see a large amount of transaction activity from private equity firms. A lot of private equity firms have both new and old dry powder to spend and will most likely be focusing on getting some deals done. At the same time the potential target companies still have a substantial need for capital to invest in their business which will be difficult to get financed through the traditional financing from the banks. There are also a lot of family-owned companies that in the coming years will need to be transferred to new owners due to the current owners being close to retirement.

Private equity firms will probably face competition from financial institutions that will consider making direct investments in unlisted mid-market companies. One of the largest pension funds in Denmark has recently announced that it has established an internal division to make such direct investments.

Finally, we expect that we will see at least the same IPO activity in the coming 12 to 18 months as we have seen in the past year.

Patricia Volhard

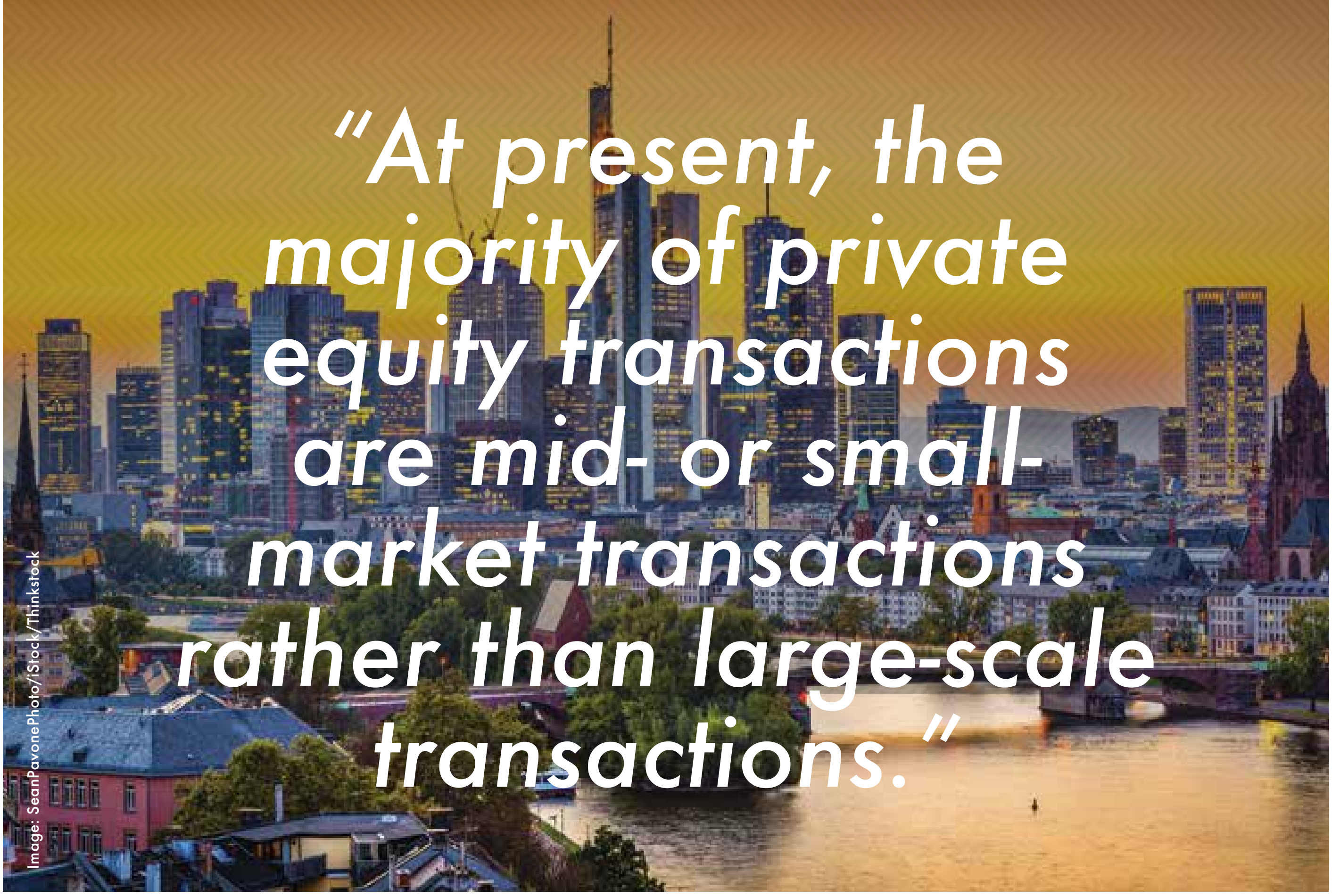
PRIVATE EQUITY IN GERMANY

Dr Matthias Bruse is one of the founding partners of P+P Pöllath + Partners. His practice concentrates on legal advice on M&A, corporate law and arbitration, with a special focus on private equity investments and family businesses. He is consistently ranked among the leading lawyers for his M&A, private equity and private clients expertise.

His publications include speeches and papers at the International Bar Association's annual conference. He has also authored numerous articles and chaired various conferences including the Munich M&A Forum.

Patricia Volhard is a partner at P+P Pöllath + Partners. She specialises in structuring private investment funds (private equity, alternative assets and real estate) with a focus on corporate and regulatory issues. She advises international and domestic fund sponsors and German institutional investors as well as private clients. She is a member of the legal advisory board of EVCA and chairwoman of the AIFMD working group.

Patricia is listed in various rankings as one of the leading attorneys in the area of cross-border fund structuring and regulatory law. *Financial News*, a weekly financial newspaper of the Dow Jones group, listed Patricia among the FN100 most influential female executives working in European financial markets. She is admitted as an *avocat à la cour* in Paris and as a *Rechtsanwalt* in Frankfurt.



GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Matthias Bruse & Patricia Volhard: The presently high stock market valuations, partly due to the monetary policy of the central banks, do have an impact on the valuation of private transactions. Consequently, the asking prices of vendors in private transactions are rather high. This has an impact on the question of whether bids of financial buyers are competitive to those of strategic buyers. Since strategic buyers are able to pay strategic premiums, they may have a considerable advantage in the present market situation.

At present, the majority of private equity transactions are mid- or small-market transactions rather than large-scale transactions. The overall deal flow is moderate with few large-scale landmark transactions happening. The overall deal flow could possibly increase if the present policy of the central banks changes, with interest rates rising and money supply decreasing.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

MB & PV: In principle, portfolio company activity is significant for the decision to purchase. However, given the present pressure on private equity investors to invest, one might expect a more relaxed approach as regards the quality of the business of the target company.

There are no specific regional hotspots in Germany. The preferred industries in which to invest are software/IT, internet/media/communications and biotechnology/pharmaceuticals/medicine.

GTDT: What were the recent keynote deals? And what made them stand out?

MB & PV: One recent keynote deal was the takeover of Celesio by McKesson. This transaction had a number of interesting features, including more than one takeover offer after missing the relevant control threshold in the first takeover attempt. Particularities of this takeover include the Federal Financial Supervisory Authority giving permission for a second voluntary tender to take place, the strategies of certain minority shareholders, in particular hedge funds, and the sale tactics of the former majority shareholder, Haniel.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

MB & PV: Given the globalisation of businesses, cross-border issues are becoming more relevant in M&A transactions. These transactions require, in particular, sophisticated tax structuring, interactive teams in the various jurisdictions and tight project management. Master agreements dealing with the overall transaction have in many cases been the appropriate device to deal with relevant issues of such transactions on a consolidated basis.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

MB & PV: Among other things, three developments are noteworthy:

Debt volumes have increased significantly, thereby potentially allowing private equity investors to pay the rather high purchase prices requested in the present markets.

Covenants appear to be less strict than demanded, in particular immediately after the Lehman crisis.

Matthias Bruse

Certain market players, in particular direct lending or private debt funds, are offering unitranche financing for certain transactions as an alternative to structured financing with senior debt, mezzanine, etc.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

MB & PV: The challenges of the last few years were mainly in the regulatory area and have had an impact on fund structures and fundraising. In terms of structuring transactions and approach to companies we have not seen any particular changes. However, the anti-asset-stripping rules under the AIFMD, which are still a source of legal uncertainty due to different interpretations in the EU member states, may become a challenge in connection with certain transactions in the future.

From a tax perspective, it continues to remain important not to engage in the day-to-day business of portfolio companies and to limit the fund's activities to mere active monitoring functions.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

MB & PV: Generally, private equity and venture capital are welcome in Germany and seem to be supported by many policymakers and the government. Shareholder activism is also playing a more important role in Germany.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

MB & PV: The exit environment is dominated by secondary buyouts and trade sales. Partly, exits are being deferred and substituted by substantial recapitalisations of portfolio companies.

Although the stock markets have developed strongly during 2013 and the first half of 2014, only a few IPOs have been successfully carried out. Consequently, the IPO is not the primary exit route for private equity investors at present.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

MB & PV: Fundraising has become subject to more burdensome regulatory requirements which were introduced in the course of the AIFMD implementation. This also concerns non-EU fund managers, who are required to obtain prior approval from the regulatory authority (BaFin). Such approval is only granted subject to meeting certain AIFMD requirements. At the same time, the upcoming regulation in Germany for insurance company and pensions funds heavily tightens the conditions for such investors to invest in private equity funds. Despite this rather difficult regulatory environment there remains important investor interest in private equity investments but not all fund managers can meet the new requirements.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

MB & PV: The fundraising process varies depending on whether the manager is based within or outside the EU and, in the former case, whether it is fully AIFMD-compliant or only registered as an exempt sub-threshold manager in its home country. In all cases marketing requires prior registration with, or approval from, the German regulatory authority (BaFin). Such registration must be completed or, if applicable, BaFin's approval must be obtained, prior to engaging in marketing activities in Germany. However, it is always possible to engage in certain pre-marketing activities (eg, submitting and negotiating term sheets but not yet using final (or almost final) fund documentation).

Key structures for German investors for private equity funds are still German, Luxembourg, UK or non-EU partnerships, in each case subject to the laws of such country. However, with the pending new regulation for German insurance companies and pensions funds, EU partnerships with European, fully AIFMD-compliant, managers may become more attractive. This is because under the current draft of the insurance ordinance, which governs under what circumstances German insurance companies and pension funds may invest, it is provided that a fund is only an eligible investment if based in the EU or an OECD country and if managed by a European, fully AIFMD-compliant, manager or an OECD based manager which is subject to equivalent authorisation. It remains to be seen under what circumstances BaFin will assume 'equivalence', so for the time being it is expected that EU structures may provide more legal certainty for such investors.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

MB & PV: Private equity fund managers are subject to the AIFMD requirements, which include the

Patricia Volhard

"Key structures for German investors for private equity funds are still German, Luxembourg, UK or non-EU partnerships. However, with the pending new regulation for German insurance companies and pensions funds, EU partnerships with European, fully AIFMD-compliant managers may become more attractive."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Germany is an important fundraising and target country. German institutional investors are subject to very specific and complex regulatory requirements which require special attention when structuring and marketing the fund to such investors. In addition, tax regimes are complex in Germany. Hence fund structuring requires special tax and regulatory expertise; the latter has become a particular challenge over the last few years.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

A client should ensure that it chooses counsel that is familiar with international market terms for private equity transactions or as applicable fund terms and structures. Moreover, it should make sure that the firm it chooses has excellent tax expertise, which is necessary not only for advising in a complex transaction on the acquisition structure but also in a fund structure to make sure VAT issues are addressed and the fund is treated as transparent. Finally, and this has become more important, over the last few years, it needs to make sure that regulatory lawyers (with AIFMD expertise in particular) are involved both in terms of advising on a transaction but more importantly also when structuring a fund.

What is the most interesting or unusual matter you have recently worked on, and why?

The structuring and setting up of the SwanCap Opportunities Fund SCS SIF and its management platform in 2013. The investment purpose of the SwanCap Opportunities Fund SCS SIF was in particular to acquire a portion of the private equity portfolio of UniCredit Bank but also to raise capital for new investments. The SwanCap Opportunities Fund SCS-SIF is managed by SwanCap Investment Management SA, an investment company that was newly founded with its registered office in Luxembourg. It was an interesting project because P+P could apply much of its regulatory, tax and corporate expertise in structuring and setting up the fund platform besides negotiating the fund terms and drafting the fund documentation.

Matthias Bruse & Patricia Volhard
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requirement to obtain an authorisation and to comply with all disclosure, management, capital, depositary and compliance requirements, unless they manage funds that altogether hold assets of not more than €500 million and provided that such funds are all unleveraged, closed-ended and all investors in such funds qualify as professional or 'semi-professional' investors (ie, investors investing at least €200,000 and having sufficient expertise and know-how). Such exempt 'sub-threshold managers' only need to register with BaFin to manage and market their funds.

Most German private equity fund managers are sub-threshold managers. The registration process with BaFin can be burdensome and require some restructuring; but there are no specific day-to-day management requirements other than certain reporting requirements relating to the amount of assets under management and the prohibition to engage in MiFID or other activities.

Alternatively private equity fund managers can apply for full AIFMD authorisation. In such case the manager is subject to supervision in terms of its management but also the fund itself, if it is a German structure, is subject to certain product rules.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

MB & PV: German sub-threshold managers are not subject to any particular requirements with respect to fundraising. German fund managers with an AIFMD authorisation are subject to the disclosure requirements and the anti-asset stripping requirements under the AIFMD, which have been implemented into German law. EU managers can market in Germany provided they have obtained the marketing passport as provided under the AIFMD. Where the non-German EU manager is a sub-threshold manager benefiting from an exemption in its home country, it can market in Germany only subject to registering with BaFin by providing evidence that it is registered in its home country and that German sub-threshold managers would be equally permitted to market in their country. EU sub-threshold managers who cannot provide such evidence cannot market in Germany.

Non-EU managers have to apply for an approval to be granted by BaFin in order to market in Germany. Such approval is only granted upon the fund manager meeting certain requirements which vary depending on whether the fund is marketed to professional, semi-professional or retail investors. Whereas marketing to retail investors is basically impossible for non-EU managers, marketing to semi-professional investors is subject to the fund manager agreeing to comply fully with AIFMD. Regarding marketing to professional investors, the fund manager must agree to meet the disclosure and anti-asset stripping requirements under the AIFMD and it must engage a depositary for the fund agreeing to assume the depositary functions under the AIFMD. The approval process can take up to four months or even longer in case of marketing to semi-professionals. Once the EU has introduced the marketing passport for third country fund managers, marketing to professional investors will also be subject to fully meeting all AIFMD requirements.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

MB & PV: In order to achieve consistency between the new regulatory rules (AIFM, KAGB) and the tax rules applicable to funds and their investors the German investment tax act was amended and became effective on 24 December 2013. For the first time, its scope of application covers UCITs as well as AIFs, including private equity funds. However, for private equity funds structured as a partnership the new law merely provides that the general rules of taxation for partnerships and their partners apply. As a consequence, the taxation of income derived from private equity funds structured as partnerships has not changed. By contrast, investments in corporate private equity funds have become less attractive from a tax perspective.

While the EU VAT Directive provides for a tax exemption for the management of investment funds, Germany implemented that EU exemption only for certain open-ended funds. As a consequence private equity funds do not enjoy this exemption and the management of German private equity funds is generally subject to German VAT at a rate of 19 per cent. Such VAT liability remains a disadvantage of the German private equity market.

Carried interest payments to German resident individuals are currently treated as 'compensation for services rendered' and, as a consequence, are generally subject to tax as ordinary income at the marginal income tax rate of the German resident individual of currently 45 per cent (plus solidarity surcharge). According to special legislation introduced in 2004 carried interest payments made by a private equity fund that is eligible for non-business treatment (pursuant to the German domestic concept of business) benefit from a 40 per cent exemption from income tax (resulting in an effective tax rate of approximately 27 per cent (ie, 45 per cent x 60 per cent)); if the carried interest is held by a vehicle that is itself a limited partnership this 40 per cent exemption is available only if the carried interest limited partnership is itself eligible for non-business treatment. Carried interest payments from (i) private equity funds that are effectively in business or (ii) funds focusing on asset classes other than private equity are not eligible for the 40 per cent exemption. There is a (more or less permanent) political debate about whether the 40 per cent exception should be abolished; it is currently impossible to predict whether, and if so when, the 40 per cent exception will be abolished.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

MB & PV: The mains challenges over the coming years remain of a regulatory nature: whereas currently many private equity managers still benefit from the sub-threshold regime under which they are exempt from most requirements, we would expect that the regulatory environment in Germany is currently such that they will be forced into full regulation (one example is the pending draft of the insurance ordinance under which a German pension fund could only invest in a fund managed by a sub-threshold manager under the so-called 'opening basket' (ie, a basket for investments that generally do not qualify as eligible investments). The same is true for non-EU managers, who under such insurance ordinance draft may not be considered to be subject to 'equivalent authorisation'. In addition the marketing rules foresee that as of the introduction of the passport regime for third country fund managers only managers with an AIFMD authorisation can market in Germany. All of this shows that there seems to be a tendency of the German policymakers to impose AIFMD requirements on all managers addressing the German market.

PRIVATE EQUITY IN INDIA

Cyril Shroff is managing partner and Reeba Chacko is a partner at Amarchand Mangaldas, where they represent several foreign and domestic private equity funds and venture capitalists, in both public and private investments, and handle all aspects of investments for clients, from due diligence to regulatory filings, open offers, as well as tax and compliance issues. Clients include blue-chip private equity funds across a range of geographies.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Cyril Shroff & Reeba Chacko: Buyouts by private equity firms are rare in India, largely because of restrictions under Indian law that apply to leveraged buyouts and prohibition on bank financing for acquiring equity shares, significantly increasing the cost of capital for private equity funds. Buyouts are more common in the mid-market space, although there are not many focused buyout funds in India (India Value Funds Advisors being a notable exception).

India has typically seen minority investments from private equity funds and this trend is continuing, although the mix is moving towards buyouts. Recently, there has been a slew of control transactions involving global private equity funds (Baring Private Equity Asia's investment in Hexaware Technologies, Partners Group acquiring CSS Corp and KKR acquiring Alliance Tires). There is a mixed trend in private equity funds in India increasing their operations teams, which could suggest that buyout funds could be in the offing.

The average size of private equity deals is increasing (and is expected to continue to increase). Investments in early and growth stage deals form the bulk of private equity investments in India. There is an increasing focus on mid-market companies, given the lower valuations and potential for value creation. Fundraising for mid-market funds has seen much better traction. While valuations seem to be rationalising, the competition in deals has not reduced significantly, mainly due to a paucity of good-quality ones. Funds are taking more time getting comfortable with value creation potential and more comprehensive due diligence is being conducted.

While we expect greater activity on this front this year, IPO exits have been rare in the past 18 months and the majority of recent exits have been by way of share buybacks and secondary sales.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

CS & RC: Investments in the real estate sector are often structured as joint ventures between the private equity investor and the developer. In most other sectors, private equity investments are usually in the form of minority stake investments, with board participation, customary minority protection and exit rights. Co-investments are increasingly common in early-stage consumer internet investments. Another interesting trend is the adoption of the 'dumb-bell' approach by private equity funds in India, resulting in blurred lines on the distinction between private equity and venture capital funds.

Recent trends in the e-commerce sector suggest a move towards consolidation spearheaded by common investors.

Certain sectors such as consumer internet, health care, information technology, consumer businesses, quick service restaurants and real estate are the front runners in attracting private equity investment.

GTDT: What were the recent keynote deals? And what made them stand out?

CS & RC: We recently advised PI Opportunities Fund in connection with the investment in Myntra, and subsequent sale of its investment to Flipkart as part of the acquisition of Myntra by Flipkart. The transaction, which was the largest deal in India in the internet marketplace space, was propelled by common private equity investors and is likely to spur a series of consolidations in this sector. After the transaction, Myntra continues to operate as a separate company in the Flipkart group and retains its fashion portfolio.

Earlier this year, we had advised private equity investor KKR in its acquisition of a minority stake in Gland Pharma Limited, a leading Indian pure-play generic injectable pharmaceutical products company, in what was the largest private equity investment in an Indian pharmaceuticals company.

The investment by KKR included the purchase of the entire stake of Evolvence India Life Sciences Fund (EILSF), thus providing an exit to EILSF, which had invested in Gland Pharma Limited in 2007. The transaction, due to the sector of the Indian company and the size of investment, required approval of the Foreign Investment Promotion Board and the Cabinet Committee on Economic Affairs, besides the Competition Commission of India. While the proposal was being considered by the FIPB, there was a change in the law relating to the conditions for investment in brownfield pharmaceutical companies, which the parties had to comply with.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

CS & RC: Private equity M&A tends to be cross-border in India if the private equity fund is located outside India (ie, foreign investment). A significant portion of foreign investment made in India is by way of private equity investment in Indian companies. Another situation where PE deals in India become cross-border is if the Indian target has overseas operations, resulting in due diligence and coordination with local counsel in various jurisdictions in this regard.

The tax treatment for divestment of foreign investment made in Indian companies (typically in secondary transactions) and availability of benefits under applicable double taxation avoidance treaties remains a major issue in cross-border transactions, with the tax analysis influencing the choice of jurisdiction of investment, the nature of security and the contractual rights and obligations of the parties, particularly relating to representations, indemnities and insurance.

Foreign direct investment is subject to foreign exchange control regulations, which set out restrictions on pricing of shares in cases of transactions between residents and non-residents (such as offshore private equity investors). Typically, sale of shares from residents to non-residents (including primary subscriptions) is subject to a floor price and sale of shares from non-residents to residents is subject to a cap. These regulatory caps and floors provide challenges in structuring investments as well as exits. Investments in certain sectors and industries require prior approval of either the Reserve Bank of India (typically if linked to valuation and modes of the transaction) or the Foreign Investment Promotion Board, a nodal governmental body for foreign investment (typically linked to the relevant industry or identity of the investor). In many cases, advisers are unable to satisfactorily predict the timing and in some cases the outcome of these approval processes. Exit options become challenging in these scenarios since Indian law prohibits the grant of fixed-price put options to non-residents.

Coordination with various teams spread over different time zones makes the execution of the transaction challenging, especially in secondary transfers involving offshore private equity funds since any sale of shares from a resident to a non-resident is permitted only after certain filings have been made with authorised banks. Timing the closing formalities in these types of transactions is a logistical exercise that needs careful planning. Recent changes to the 'know your customer' norms essentially require furnishing of information about the ultimate beneficial ownership and source of funds of foreign investors, which need to be handled carefully. Demat account opening processes operate on similar lines and these processes are being increasingly more time-consuming. The depreciation of the Indian rupee also creates concerns, especially from an exit perspective, especially given that long-term hedges are prohibitively expensive.

Multi-jurisdictional deals also require an analysis of competition law provisions in all jurisdictions involved. Further, the choice of dispute resolution mechanism is heavily negotiated, with foreign parties preferring to have disputes settled by arbitration outside India and Indian parties resisting offshore arbitration due to the high costs involved.

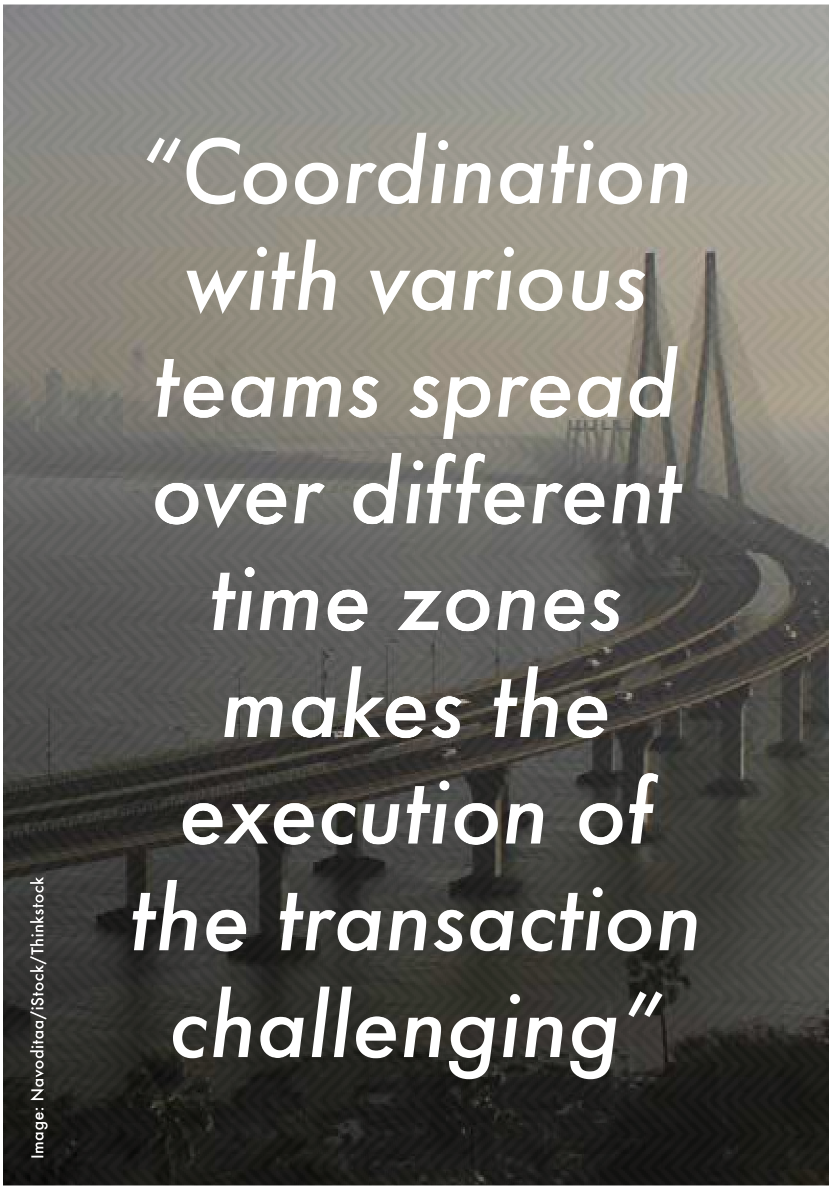
GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

CS & RC: As mentioned earlier, bank financing of equity transactions is not permitted in India. Consequently, offshore acquisition financing models are explored sometimes. Even these have challenges, since it is not always possible to collateralise the securities of the target Indian company.

One interesting trend has been that global private equity shops (such as KKR) have set up non-banking finance companies in India that provide debt funding or mezzanine funding to Indian target companies, which offer a good alternative to banks for funding. These local operations are financed by direct offshore equity or from leveraging the domestic bond market.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

CS & RC: The pace of regulatory change in India has been increasing over the last few years. The



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corporate law regime has been revamped with a new company law legislation replacing the Companies Act, 1956. The new companies act focuses on improving corporate governance at all levels (whether listed, unlisted or private) by creating a proper governance framework with adequate responsibilities, oversight, regulation and processes being prescribed. The new companies legislation codifies rights and duties of directors, defines related parties and sets out an adequate regulatory framework for dealing with related-party transactions, addresses conflicts of interests between owners and managers and sets out processes and systems for important aspects such as capital raising, all of which have a positive overall impact from a private equity investor's perspective. However, the liabilities attached to directors may be a relevant consideration where private equity firms nominate representatives to the board of directors of the portfolio companies. In a significant recent development SEBI has introduced similar changes to the governance regime for listed companies: the principle of 'majority of the minority', ie, certain situations where the minority shareholders effectively determine whether certain transactions should be undertaken or not (such as related-party transactions and certain types of restructuring involving the substantial shareholders). These principles are now applicable across companies in defined circumstances.

The long-standing ambiguities with respect to enforceability of call and put options for shares of listed and unlisted public companies have been resolved to a large extent by SEBI, the securities regulatory body and the exchange controller regulator, RBI – with the position being that fixed-price put options by non-residents are not permitted. SEBI has recently introduced a set of regulations to govern and monitor fundraising from high net worth investors in the Indian market. This has necessitated that any private equity fund domiciled in India and raising money would need to register itself under these regulations with SEBI. The regulations stipulate conditions relating to matters such as minimum diversification, conflicted transactions, change in investment strategy and borrowing limitations.

The tax environment has also undergone change, with Mauritius being slowly replaced by Singapore as the preferred jurisdiction to make investments into India, even though there are requirements to ensure that there is a significant presence and operations in Singapore. Private equity funds are willing to consider this alternative given the perceived uncertainty around Mauritius, with similar requirements being sought to be introduced for Mauritius and the anticipated anti-avoidance rules being much discussed. Last but not least, various sectors in which foreign investment was restricted have been progressively liberalised by the Indian government. Barring a few sensitive sectors such as multi-brand retail, insurance and defence, most sectors can avail of 100 per cent investment from outside India.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

CS & RC*:* Shareholder activism has grown significantly in India, but this has largely been targeted towards the promoter-run management of listed companies, given that Indian companies are largely driven by promoter shareholders, who have significant ownership and control of these companies. Such shareholder activism is being driven by recently incorporated proxy shareholder advisory firms and their stated objective is to enhance corporate governance standards and practices of listed companies with the support of institutional investors, including private equity shareholders.

The foreign investment promotion board has been supportive of proposals of investment by foreign private equity funds, even in sensitive sectors like pharmaceuticals, realising that such funds are an important source of growth capital for Indian companies, and that sophisticated financial investors tend to improve corporate governance standards and internal systems of companies. Regulators and lawmakers have also encouraged providers of risk capital by introducing tax benefits to venture capital investors, greater flexibility in pricing being given to foreign venture capital investors, certain concessions being made for financial investors such as private equity funds in the level of disclosures under securities regulations as well as limited exemptions from notification to the competition regulator. With the proliferation of private equity capital funding start-ups in India, we may witness greater interaction with policymakers in the future.

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GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

CS & RC: The Indian capital markets had been seeing a slump in recent times making exits through IPOs a rare phenomenon over the last couple of years. This is expected to change with the change in sentiment brought about by the election of a new government in India. IPO preparation for companies has begun following the surge in the capital markets in the last few months. Recently, exits have been largely by way of secondary transactions, whether buy-backs to the investee company/promoters or to other PE funds.

An interesting form of 'quasi-exit' has been the recent consolidation of the businesses of online retailers Myntra and Flipkart. The private equity investors of Myntra have become shareholders of Flipkart, and this would provide them a platform to secure an exit through an offshore listing in the future.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

CS & RC: With institutions such as the Institutional Limited Partners Association (ILPA) playing an active role in the private equity space, investors have collectively become more conscious about their rights and areas in which they need to exercise diligence. Since 2008, markets have been favouring investors and this is best evidenced by a favourable movement in fees which has been common across all markets, including the funds raised in India by Indian fund managers. Indian private equity fund structuring in India witnessed a regime change in 2012, with SEBI notifying the Alternative Investment Fund Regulations (the AIF Regulations). The AIF Regulations also demonstrate a leaning towards investors, giving them a fair amount of power with the residual fiduciary obligations resting with sponsors. Fundraising levels are beginning to pick up, with the India interest currently being driven by a central government that has been given a clear mandate. It is expected that decisive governance and policy formulation will fuel fundraising in the coming months.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

CS & RC: After establishing the pooling structure, the last few years saw timelines of up to 24 months for capital raising. As discussed, it is expected

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Since India is an emerging market, there is a fair amount of market practice and custom that is relied on, especially for private equity transactions. Given lack of precedents for determining enforceability of various provisions of private equity transaction documents, in-depth research and first principles are relied on to provide suitable assessments on enforceability. Due diligence is another challenging aspect of a private equity transaction, given that there are not many public records available. Planning for adequate exit mechanisms and establishing better corporate governance are other challenging issues, which require a liberal mix of experience, problem-solving traits and practical lawyering.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

It is essential to choose counsel that can advise the client seamlessly across practice areas, and has adequate access to experienced capital markets and restructuring lawyers, since these are integral to a successful private equity practice. Another relevant consideration would be the availability of experienced lawyers advising, since the lawyers handling the matters should be able to understand the commercial aspects of the transaction and offer practical advice based on custom and market practice. It is also important to have good bench strength and availability of senior lawyers to pay adequate attention to all parts of the transaction, since client servicing is especially important, particularly given that Indian corporate law firms do not have the scale and depth of foreign law firms.

What is the most interesting or unusual matter you have recently worked on, and why?

Each matter, regardless of size or nature, presents its own set of complexities, and is therefore interesting and challenging in its own way. While it is difficult to single out a particular transaction, the recent change in the regulatory framework has often meant that we have been involved in setting the precedent under the new or changed law.

Cyril Shroff & Reeba Chacko
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that fundraising will improve and as such the gap between initial and final closing of funds is likely to get shorter. AIFs can be set up in the form of a trust, company, limited liability partnership or a body corporate, in accordance with the relevant Indian legislation governing such vehicles. There are other non-typical investment structures such as non-banking financial companies, however, which are not used for conventional private equity funds. Key contractual points that are usually negotiated by large investors include the fundraising period (particularly by initial close investors who are conscious that they are providing debt-like risk for subsequent investors for an equity-like return), carry entitlement of the fund manager (including on removal of the manager for cause and without cause), sharing of broken deal expenses, clawback quantum and time limitations and governing law (English law still remains a clear favourite). AIF Regulations have divided AIFs into three categories (category I, category II and category III). Depending on the category of registration of an AIF, general investment conditions are prescribed under the AIF Regulations. These conditions include minimum diversification, conflicted transactions and investment in associated entities. Further, AIFs that receive foreign investment may be subject to restrictions contained in foreign investment and exchange control regulation such as sector limitations, maximum investment limits, and pricing norms.

GTDT:How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

CS & RC: The three categories of AIF mentioned above have different degrees of oversight by SEBI. Category III AIFs, which are funds that employ diverse and complex trading strategies, are subject to maximum regulatory oversight. Category I AIFs (which are given certain benefits under attendant regulation) are subject to a slightly lesser degree of supervision, with Category II (being the residual bucket) being subject to the least. SEBI, rightly so, is requiring greater disclosure by AIFs to their respective investors. Recently prescribed requirements include biannual updates and dissemination of placement memoranda, providing exit options to investors in case of material changes to the AIF and a substantial annual reporting to SEBI (to ensure compliance with nearly every single requirement under the AIF Regulations). While supervision should not affect investment business of AIFs, it definitely requires more active monitoring and compliance: all in the rightful interest of investors.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

CS & RC: In a purely Indian scenario (ie, Indian private equity fund with an Indian fund manager) the AIFMD has no effect. However, the AIFMD does have an impact where Indian fund managers are looking to raise funds in the European Union. In such cases, fund managers are more conscious of private placement and ensure early consultation with legal advisers prior to embarking on any efforts in the EU.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

CS & RC: Statutory tax pass-through is currently available only to category I venture capital funds, with other funds having to be structured to reach the same end. Besides these, there are no other significant taxes payable in respect of AIFs (aside from documentary duties on execution). Carried interest will be taxed depending on the manner in which it is paid out, namely it will be taxed as either business income or capital gains. The General Anti-Avoidance Rule, which is currently scheduled to be effective from 1 April 2015 has made tax-sensitive fund structuring imperative. Recent developments in respect of treaty renegotiation between India and Mauritius have raised concerns and uncertainty for foreign investors using Mauritius for routing investments to India. That said, the Indian administration has recognised the negative sentiment caused by a number of tax-related factors (including the uncertainty on taxation of indirect transfers of Indian assets at an offshore level and retroactive amendment to tax laws) and is looking to take active steps to reignite foreign investor confidence.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

CS & RC: In our view, the recent changes in the regulatory landscape as well as the change in government will spur private equity activity in India on the whole. The regulators have also been taking steps to ensure clarity and certainty in the rules.

Real estate and information technology enabled services (including e-commerce platforms) will continue to attract investment. We are likely to witness private equity investor driven consolidation of similar businesses to attain larger scale and increase shareholder value. Investors would also look to invest in Indian businesses through investments in an offshore holding company, for greater flexibility in raising capital, M&A activity and exits.

Investors are also likely to take a more conservative approach in respect of contractual rights they seek to avoid being classified as promoters of the portfolio companies. Similarly, the nominee directors of private equity investors on portfolio companies are expected to be more diligent while participating in the board process due to the stringent liability on directors. Corporate governance standards are also likely to improve across the board, making the environment more conducive to private equity investments.

Exits will also play a key role in determining whether sustained interest will continue. It will be interesting to see how exits will be structured since a lot of exits have been delayed due to a tepid stock market and a lack of liquidity in the Indian capital markets. We expect to see more creative exit options in the near term, making it an interesting year for private equity in India.

PRIVATE EQUITY IN INDONESIA

William Kirschner is a US-qualified corporate partner in Linklaters' Singapore office. He has extensive experience acting for private equity investors and multinational corporations on mergers and acquisitions and joint ventures in South East Asia and India.

Recent experience includes advising: CLSA Capital Partners on a Series A investment in an Indonesian agricultural company; Champ Private Equity in its US$200 million acquisition of a 33 per cent stake in Miclyn Express Offshore Ltd, an ASX listed oil services company based in Singapore with operations in Indonesia; Lehman Brothers on the sale of their interest in a leading media company in Indonesia; Rajawali Group on the sale of their Bentoel tobacco business in Indonesia to British American Tobacco for approximately US$400 million; a financial sponsor on an investment in a joint venture for the development of hospitals in Indonesia; a financial sponsor on the proposed acquisition of a leading wireless telecoms business in Indonesia; a financial sponsor on a series of investments in the oil and gas sector in Indonesia.

Image: WarrenGoldswain/iStock/Thinkstock

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

William Kirschner: Generally, private equity activity levels continue to increase significantly across the region. There are an increasing number of buyout opportunities, including in the lower and mid-markets, although growth equity, minority investments are still the predominant form of investment. The consumer sector is the hottest sector in the region, focusing on domestic consumption rather than the traditional export-oriented sectors, and we have seen a significant increase in health-care and financial services deals.

Indonesia remains an interesting and active market for private equity and is one that is viewed with a mixture of optimism and realism. Strong GDP growth and investment grade ratings are tempered by significant competition, high asset prices and relatively few mature targets. We are seeing more funds take a longer-term view to the market and establishing boots on the ground to develop relationships (and in some instances partnerships) with local players.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

WK: Traditional buyouts have always been difficult in South East Asia. A combination of restrictions on foreign ownership and the reluctance of founding families to relinquish control of their businesses means minority-stake investments and joint ventures are the more usual avenues for investment by private equity. But with generational shifts, realignment and global aspirations of certain regional conglomerates and an influx of foreign capital, we expect buyouts to become more common.

GTDT: What were the recent keynote deals? And what made them stand out?

WK: Consumer-related sectors have been particularly attractive to private equity funds in the region and CVC Capital Partners' partial sell-down of its interest in the Matahari Department Store Group in Indonesia is a good example of the potential of the retail sector.

Carlyle's first investment into South East Asia is also a deal worth noting as it paid approximately US$100 million for a 25 per cent stake in the publicly traded Indonesian telecom towers operator, PT Solusi Tunas Pratama TBK (STP).

One of the highlight deals of the past 12 months, however, has been TPG's partial exit from Bank Tabungan Pensiunan Nasional (BTPN) via a sale of a 40 per cent stake to Japan's Sumitomo Mitsui Banking Corporation (SMBC) for US$1.5 billion. This transaction not only represents the highest-value acquisition of a bank entity in Indonesia to date, and is the largest deal to have completed under Indonesia's strict new regulations (which have been in place since July 2012), but it is another key example of a profitable exit by a private equity house in Indonesia. TPG and its Indonesian affiliate, North Star, are likely to have realised more than 7.7 times their initial US$195 million investment (made in 2008). The deal also represents a continued enthusiasm across the financial services sector.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

WK: Yes, virtually all private equity deals in South East Asia are cross-border, and increasingly, multi-jurisdictional.

Uncertainty surrounding regulatory frameworks is a key challenge when advising clients as the jurisdiction is a continually evolving regulatory environment. If we take the rules with regard to foreign direct investment as an example, these are reviewed and changed on a regular basis. Some sectors are either wholly or partially closed to foreign investment. This creates both uncertainty as to the feasibility of potential investments as well as certainty of future exits.

The government has also faced accusations of 'economic nationalism' in its regulatory policies, particularly in the natural resource sectors. Add to this the increasingly federal structure of governance in Indonesia, with provincial and state officials taking on greater authority, and regulatory paralysis deriving from the government's increasing focus on anti-corruption investigations, and it can be a difficult environment to invest in profitably.

Guiding clients through this environment is a key part of our role. Most of our clients are seasoned veterans of the private equity world but there is still a process that has to take place whereby we familiarise them with the differences in regimes when compared to those with which they are more accustomed.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

WK: Senior secured debt is one of the more common forms of financing for private equity transactions in Indonesia, more so than the likes of mezzanine debt, although we do see instances of this. The security package tends to be quite broad as lenders are keen to take all the security that is available to them, the preference being to take security over offshore bank accounts and offshore shareholdings owing to uncertainty regarding enforcing security in Indonesia. Most financings opt for SIAC arbitration in Singapore as a means for dispute settlement.

While there has not been any notable development in the availability of debt financing or the financing terms in the past year, there has been a surge of interest toward Islamic financing structures, particularly by lenders based in the Middle East. These types of structures are not without uncertainty as Middle Eastern banks continue to work to adapt these structures to the Indonesian regulatory landscape.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

WK: There have been many legal and regulatory developments in Indonesia in the last few years. In our view, this reflects the contradictory trends of liberalisation to promote capital inflows and protectionism to promote domestic industry. We view this process as a healthy hallmark of a developing democracy but for our private equity clients, ongoing political, legal and regulatory uncertainty is a serious impediment to entry.

On a micro level, there is disappointment that the new Negative Investment List published in April 2014 did not liberalise certain sectors of interest to private equity investors, such as telecom towers or retail, although there was some positive news in the health-care sector.

There is also concern that the New Financial Services Authority (the Otoritas Jasa Keuangan (OJK)), which came into force in January 2013 as an independent body to supervise Indonesia's financial services sectors, is now having to self-fund. This has raised concerns that the OJK will enforce its rules more aggressively, including in respect of capital markets regulations applicable to public deals (for example, the rules on triggering a mandatory tender offer).

As a final example, the issue of new regulations relating to foreign control of listed company's by BKPM and then relatively swift retraction of such changes (notably Regulation 5/2013 and Regulation 12/2013) is an indication that we are still some way from the legal and regulatory certainty that foreign investors crave.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

WK: Private equity is relatively new to South East Asia. As such, there is a need for general partners to educate both the corporate community and policymakers about the positive role it can play. Our clients often tell us that the 'story' they need to tell is different than in Western markets, and often more focused on corporate governance, financial discipline and professional management. However, the market is becoming more familiar with private equity, and there is increasing appreciation for the benefits it can bring in terms of scaling businesses domestically and regionally. Shareholder activism, as yet, is not a significant feature of the Indonesia marketplace.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

WK: The traditional exit routes have been through the capital markets (IPOs) and trade sales to strategics. We have seen an increase in exit activity and we believe this is a trend that will continue as investment horizons are reached and general partners are raising new funds.

Image: cpaulfell/iStock/Thinkstock

Value is always the biggest driver for determining exit strategy. We have seen more trade sales in recent years given disruptions in the capital markets and cash-rich multinational companies willing to pay high premiums for growth opportunities in Indonesia. We expect more IPO exits as the capital markets begin to stabilise.

We are also beginning to see secondary sales, from one private equity house to another, in the region. This has involved individual assets as well as portfolios of assets. It represents an opportunity for funds with little or no exposure in the region to gain exposure relatively quickly through more experienced managers. It also reflects the scarcity of attractive targets for private equity buyers.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

WK: For the reasons mentioned previously, Indonesia still garners a lot of interest on the global stage when it comes to investment, and sponsors looking to raise funds have a strong story to make their case for investment. There are new Indonesia-dedicated funds that compete with regional and global funds looking to deploy capital in the country. There are currently over 30 private equity funds in the market, including real estate and infrastructure, that have Indonesia as part of their geographic focus and that have billions of dollars of commitments. This would suggest that fundraising, by established names and new funds, is strong at present.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

WK: The process and timelines involved will vary based on several factors. For example, the set-up of a successor fund to a well-established private equity fund manager with an existing management infrastructure will, in theory, be a quicker and simpler process than establishing a fund for a manager seeking to raise a fund for the first time.

That said, at a high level the process will typically involve a number of key features.

To start with you need to determine the nature and location of the fund vehicle. This will be influenced by a variety of factors including tax efficiency; specific investor requirements or considerations; the need for an established network of service providers; the need for a reliable and respected legal system; accessibility to the fund management team; and ensuring a vehicle is used that is well known to the target investor base and therefore marketable.

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Few if any countries match Indonesia for the level of interest it generates with investors across the globe. It is an emerging democracy with the fourth-largest population in the world and vast natural resources. While this is in itself exciting, the challenges that prevent it reaching its 'full potential', such as the opaque regulatory landscape, reputational issues and the resistance of asset holders to sell, means it is one of the most complex jurisdictions in which to execute a successful transaction. It is in large part still a question of risk/reward, with pricing being key.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

1. Experience in the region: you need to work with a firm that has the pedigree executing successful transactions in the region across a diverse range of sectors.

2. Presence on the ground: you need to work with lawyers who know the market and who have spent time in the market so they understand and can interpret the legislation and regulations in line with market practice. Coupled with this is language capability: you need to work with a firm that combines both English and Bahasa Indonesia language capabilities to enable quick and effective communication on transactions.

3. Significant Asia footprint: the multi-jurisdictional nature of the deals that take place in Indonesia means your counsel needs to have offices in each of the keys jurisdictions across Asia. For example, the SMBC acquisition of a stake in BTPN involved a Japanese investor acquiring an Indonesian asset but was coordinated from Singapore. It is a region where personal relationships are key.

What is the most interesting or unusual matter you have recently worked on, and why?

Undoubtedly, SMBC's acquisition of a 40 per cent stake in BTPN, from sellers including TPG.

The deal truly reflects the complex, high-value, first-of-their-kind transactions we execute in Indonesia. The deal was the largest foreign investment in the Indonesian financial institutions sector to date; the first deal in which an overseas investor has been approved as a 'fit and proper' shareholder of an Indonesian bank since the transition of banking supervision from Bank Indonesia to OJK took effect on 1 January 2014, and the largest deal to have completed since the introduction of new banking regulations in Indonesia in July 2012. It is SMBC's biggest purchase of a foreign financial firm to date (and the second-largest by a Japanese bank in Asia to date).

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In parallel, the broader fund structure needs to be developed to determine how the fund will be managed taking into account the complex body of regulation governing the management of such vehicles while also determining an appropriate downstream structure for the fund's proposed investments to ensure at the outset the fund's structure is legally and commercially viable and tax-efficient.

Next, a summary of terms will need to be prepared, setting out the key fund terms at a high level, which are used as a basis for discussing the fund with prospective investors. This serves to ensure that there is sufficient interest in the fund among cornerstone investors at an early stage (before significant expense is incurred in establishing the fund structure), and that there is broad agreement as to what the main terms are in order to hopefully minimise changes to the fund documents when they are being drafted and negotiated.

Once the fund terms are agreed, the suite of fund documents are drafted and negotiated with investors.

Finally, once the fund documents have been drafted and agreed and, assuming all relevant entities within the structure have been established and any regulatory filings and approvals have been completed, the fund can proceed to close.

The timelines involved can vary greatly, from three months for a fund where an existing management structure is in place and fund terms are agreed with investors relatively quickly, to more than a year, where more complex structures are involved and/or where investor negotiation has been particularly significant.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

WK: There is no dedicated supervision of private equity sponsors above the existing regulatory regimes, which as mentioned can be difficult to navigate and subject to change. There are regulations for venture capital companies but these are special vehicles regulated by the OJK and are not typically used by foreign investors.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

WK: Although the Alternative Investment Fund Managers Directive (AIFMD) is European Union legislation, its impact is being felt by fund managers globally, including within Asia. The fact is if you are establishing a fund that is domiciled within, managed from within or marketed to investors within the European Union you will be subject to the provisions of the AIFMD in one way or another. In practice, this means fund managers are having to consider at an early stage in the fund structuring process the extent to which the AIFMD will affect the way in which they structure, manage and operate their funds.

For managers outside the European Union, it is the rules relating to marketing of fund interests to EU investors that are likely to have the biggest impact. Funds marketed into Europe on a private placement basis are required to be registered with individual member state regulators and to subject themselves to certain ongoing regulatory reporting requirements. In addition, disclosure documents will need to be checked to ensure they satisfy the mandatory disclosure requirements of the AIFMD. In some member states, the act of registration can add significantly to the fundraising timetable. The additional burden of complying with these requirements, as well as the complexity of dealing with varying requirements in different member states means that some managers for whom Europe is not a central part of their fundraising plans are choosing not to market their funds there.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

WK: We expect interest to remain strong in Indonesia for the foreseeable future with the key focus being on the sectors powered by the growing middle class. Deals based solely on income and population growth, however, will be harder to come by since many of the obvious targets have already been scooped up. General partners will have to dig deeper into the mid-market, where small and medium-sized enterprises account for almost 60 per cent of GDP.

Being 'in the market' will be key and foreign funds will need to maintain a strong local partnership or presence as accumulating local market intelligence in Indonesia relies heavily on personal relations. Formal private equity participation is still an alien concept to many owners of small-scale and family-run enterprises in Indonesia and therefore familiarity with the local business culture will prove crucial to capitalise on the sorts of deals that need to be created rather than discovered.

While competition for (and scarcity of assets) has clearly intensified, private equity capital in Indonesia is still low in relation to the overall economy and the national stock market. This points to the long-term growth potential of the industry. While overall M&A activity will continue on a steady line upwards, we anticipate that private equity's share of that M&A space will increase.

The main factor will be whether enough opportunities arise during the next few years as new cash needs to be deployed to meet investor expectations. There is a lot of optimism about South East Asia becoming a core destination of private equity, along with China and India, but there is less certainty as to whether managers can make money.

Aian Abbas

PRIVATE EQUITY IN ITALY

Aian Abbas is a partner in the corporate department of Ashurst LLP. Her practice focuses on M&A, banking, finance and restructuring, representing international and domestic clients, mainly focusing on private equity M&A and leveraged finance transactions.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Aian Abbas: The Italian market has slowly continued its growth in volume and churn of deals from the low points of 2009. However, the increase in activity has not resulted in a growth in market cap of deals. Large-scale buyouts (in excess of €100 million) remain rare in Italy and in the wider market there have only been about 10 of these in the past couple of years. Large-scale transactions remain outside the ambitions of many local and external private equity investors.

As with the general market for private equity in Europe, a considerable amount of under-committed capital has started to become available for both inward investment in transactions in Italy from non-Italian private equity investors and from domestic Italian funds. This 'dry powder' is starting to be deployed with more confidence. Again, in line with the general European trend, in the absence of available targets or liquidity for larger-scale deals, private equity investors have become increasingly drawn into the mid-market size deals of which

there has been a significant increase. The market has seen a move away from active minority stakes being taken in private companies and an increased focus in the traditional full leveraged buyout model involving first-time entrants to the private equity market. Within this there has been a trend for first-time buyout companies being targeted by PE houses. We have been very active in this segment of the market, representing some of the most well-known PE Italian houses, including Fondo Italiano d’Investimento SGR, NEM SGR, Idea Capital Funds SGR, Emisys Capital SGR and Gradiente SGR.

The leveraged market has started to reopen for Italian deals partly due to the settling of nerves around the European economy and also due to governmental attempts to stimulate leverage, for instance the growth of Italian mini bonds which allow businesses to issue their own forms of debt mirroring the general growth of other forms of credit provision for transactions seen in the more mature European debt markets. However, the fact that traditional family-run companies no longer have as much available credit has also forced many of them to consider private equity as an alternative source of funding. We do not yet have the multiplicity of funding sources seen in the UK.

The gap in valuations as between buyers’ offers and sellers’ valuations has closed somewhat and investors have also been more willing to innovate in trying to bridge the gaps using deferred payment mechanisms or vendor loan notes. There have also been instances of more complex equity structures being employed to incentivise management teams.

The Italian PE landscape has recently been experiencing a timid revival of competition in the context of auctions, especially in connection with specific sectors (apparel and luxury, leisure and hospitality), driven by the involvement of Asia-Pacific investors.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

AA: The majority of international players who are looking at Italian assets are still pursuing straight buyouts but these international players have made very few deals in Italy (although this is starting to change with houses such as Carlyle and Electra expressing an interest in transacting with Italian businesses).

In the meantime the current private equity community continues to invest in minority stakes in their targets but with enhanced rights to shareholder information and vetoing certain activity. Domestic focus is on minority-stake investment. In this respect, Ashurst recently acted for NEM SGR and Idea Capital Fund SGR in relation to the acquisition of a minority stake in the capital of Meta System SpA, an Italian company leader in the business of research, development and production of electronic security systems for the automotive and home security market, having as clients the leading automotive companies worldwide.

However, we do not see joint ventures or consortiums of private equity houses acting to pursue particular investment opportunities at the moment and this is probably a reflection of the digestible mid-market deal sizes at the moment with few houses acting outside their comfort zones.

GTDT: What were the recent keynote deals? And what made them stand out?

AA*:* In terms of keynote deals, the re-emergence of the larger and European private equity players making strategic investments in the jurisdiction over the last 18 months or so is a sign that confidence has returned to the fundamentals of Italy's transactions environment. As an example, in June 2013 Carlyle acquired Morelli Matori SpA from Melrose Industries.

We have also seen acquisitions by clients such as Apax in their purchase of Rhiag-Inter Auto Parts Italian (an automotive parts business) from Alpha, which itself bought from CVC. Also noteworthy was Charterhouse Capital's purchase Doc Generici, an Italian pharmaceutical company.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

AA*:* There has been an increase in multi-jurisdictional private equity deals that involve Italian assets.

The key challenges are cultural – the major international players (wrongly) do not see Italy as reliable or do not trust the system. Language and cultural difficulties rather than technical or legal difficulties are the main challenges.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

AA*:* Senior debt continues to be the most regularly used debt form with security taken over all assets while mezzanine finance remains available. We are starting to see other methods like second lien potentially discussed.

There has been a trend towards vendor financing in international deals caused by the excess of leverage within the target companies. By this we mean that vendors have been required to or offered to defer some of their proceeds by way of loan notes or other forms of equity-debt investment or take a direct stake in the business. Domestic deals have tended to be financed by bank debts and have experienced the consequential squeeze on credit.

The Italian authorities have had to balance providing incentives or tax benefits to stimulate liquidity in the private equity market against the prevailing backdrop of cuts and general fiscal austerity.

However, it is notable that over the past couple of years we have seen moves by the state to back its own private equity funds such as F2i, while in April of this year Unicredit and Intesa set up a bad loans vehicle with KKR to house some of their poorly performing loans.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

AA*:* The structure of private equity investments in Italy has settled over time on the use of common

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

In the areas in which the bulk of Italian private equity investments are made, (particularly high-end fashion, engineering and services) Italian private equity professionals are knowledgeable and experienced in all aspects of the consistent parts of the deal. We are also more receptive to new forms of financing or other structures and are willing to find solutions rather than being bogged down with the process and regulation.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

The most important thing is to pick lawyers who understand the business drivers for the private equity investor and those issues that really matter. We think it helps to have counsel who are plugged into a commercial network who are used to operating as part of an international team whether by way of direct investment or as part of a cross-border deal. The private equity market in Italy is relatively small and it is usually the case that investors have long-standing relationships with their preferred advisers.

Clearly if you are using an Italian counsel as part of a complex and/or cross-border team, their command of English (both oral and written) is crucial!

What is the most interesting or unusual matter you have recently worked on, and why?

We are currently involved in three cross-border deals involving foreign private equity houses at the moment and two of them relate to assets as targets that are based in Italy and that are essential for the business. It is therefore interesting to be involved in all parties' conferences where we are requested to explain Italian tax and structuring to other European counsel.

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> "The key challenges are cultural – the major international players (wrongly) do not see Italy as reliable or do not trust the system. Language and cultural difficulties rather than technical or legal difficulties are the main challenges."

investment funds managed by a Italian general partner management company (called *società di gestione del risparmio* (SGR)).

The common investment fund takes the form of an independent fund of assets managed by SGRs, authorised to operate by the Bank of Italy and generally regulated under the Finance Consolidation Act since they are treated as financial intermediaries. In particular closed-ended funds Fondo Comune di Investimento Mobiliare di Tipo Chiuso are most commonly used to provide the structure for transactions.

The most important recent reform has been in respect of the Alternative Investment Fund Managers Directive (AIFMD). The AIFMD entered into force on 22 July 2013; however, its full implementation has not yet taken place.

Unlike other jurisdictions in which the regulations enter into further to lightly unregulated market, as noted above the regime around SGRs and the closed-ended investment funds is more limited and restrictive of foreign investors and the marketing of Italian investors by such bodies. The AIFMD should significantly ease the burden of reputation in this regard.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

AA: Shareholder activism does not play a significant role in private companies at all. However, due to historical deals (for example, Ferretti or Seat Pagine Gialle) there has been an increase in scepticism towards private equity deals transacted with an excess of leverage incurred by the target.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently and why?

AA: IPO is still the preferred exit model for large deals. Typically a target will attempt an IPO exit first. Recently there have been many exit attempts, but few exits actually completed. This is usually unsuccessful and is then followed by trade sales. The majority of large-scale exits have ended with selling to strategic buyers.

With small-scale minority investments, the typical exit route is selling back to the majority shareholders.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

AA: As with the rest of Europe the market has swung away from the fund sponsor and is still with the various steams of investors who remain cautious about the use of their funds. It should be noted that much of the private equity investment of the last year has taken the form of reinvestment or refinancing of current portfolio companies as opposed to new deals. Closed investment funds are required to specify clearly in the fund's rules the identity of the main asset classes in which the fund will be investing so there is a level of specialism that is perhaps different from other jurisdictions.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

AA: As mentioned, the process of creating a fund and SGR in Italy is more formally regulated. The SGR must be authorised by the Bank of Italy and must also be included in a register. The assets of the fund are also required to be held by a custodian bank. The Bank of Italy's involvement remains the same whether the fund is a foreign limited partnership or set up in Italy, since the Bank of Italy monitors financial investments (including funds) that are introduced or offered into Italy. The fund must also set out its rules and the outline purposes and policies of the fund including:

- the persons within the fund charged with the selection of investments;
- the terms of investment and commitment;
- the various asset clauses in which the fund will invest; and

- (crucially and most importantly) the management fees due to the SGR and other investor charges.

The time for setting up a fund from the outset depends on the amount to be raised and number of investors, but a fund can usually be incepted within 12 months, including the authorisation period from the Bank of Italy. However it is never the technical set up process that holds up the set up timetable – the main thing is around wooing investors and obtaining their commitment.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

AA: There is no straightforward answer – it depends on the specific private equity company, fund, deal etc, but generally speaking supervision does impact day-to-day business.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

AA: There has been a proliferation of small funds (€40 million–100 million). These tend to be dedicated to domestic market and first-stage fundraising occurs in domestic territory. Second-stage fundraising may be conducted internationally.

There has also been a proliferation of initiatives, and funds launched, that are dedicated to hybrid investments, of which private equity is a part but does not make up the whole.

In terms of relevant fundraising initiatives there are 20 to 30 still in the process of closing so we will need to wait to see the outcome of these.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

AA: The legislative environment is one that is aware of the twin and opposing issues of collecting more revenue via tax as part of its austerity measures while trying to incentivise growth to develop the economy.

Italian investment funds are not subject to income tax and the Italian government is looking at methods of stimulating investment in start-up companies with regard to debt financing. The legislature also looks to help stimulate growth by applying a more favourable tax regime for bonds as like securities issued by banks (in addition to the mini bonds mentioned earlier). However there are no specific tax reliefs or incentives that have been designed for management investors (compare with schemes such as Entrepreneurs' Relief in the UK).

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

AA: We hope to see an acceleration of activity and a consolidation of action in the mid-market.

We also hope to see an increase in successful IPOs as an exit method.


Zenya Onishi


Hiroya Yamazaki


Eriko Sakata

PRIVATE EQUITY IN JAPAN

Hiroya Yamazaki, Eriko Sakata and Zenya Onishi practise in Linklaters' Tokyo office in its dedicated private equity and financial sponsor coverage team in Asia, working together with M&A, acquisition finance and capital markets practitioners.

Recent transaction highlights have included advising: SMBC and Nomura Capital Investment as senior mandated lead arrangers on the ¥68.9 billion refinancing of the leveraged facilities for the acquisition of BellSystems 24, Inc by Bain Capital; NTT Communications Corporation on its acquisition of up to 91.2 per cent of stakes from AXA Private Equity and other shareholders in Arkadin International SAS; and Mizuho Securities on the set-up of a Singapore limited partnership as a JV-type private equity fund to invest in companies in India with Tata Capital General Partners.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Hiroya Yamazaki, Eriko Sakata & Zenya Onishi: There has been a constant flow of private equity deals in recent years, although the majority of deals in Japan are centred on the small/mid-cap market. Transaction volume of large-cap deals (ie, over US$500 million) tends to fluctuate on a yearly basis. Private equity deals are known to be challenging in Japan due to the difficulty of building relationships with the management of the target company and the vendor or founders, in the case of small/mid-cap companies. However, there are two notable trends that could have the effect of reversing the trend and encouraging more private equity buyouts and investments at all levels of the market.

First, aided by the government's pro-growth economic policies under the leadership of Japanese Prime Minister Shinzo Abe, Abenomics has had some success in encouraging companies to increase their profitability by selling their non-core or poorly performing assets. Large well-known conglomerates such as Panasonic, Hitachi and Sony are actively divesting their non-core businesses

Image: SeanPavonePhoto/iStock/Thinkstock

in order to refocus their activities on core businesses and such spin-offs and divestures have consequently created investment opportunities for, and raised public awareness of, private equity sponsors.

Second, there has been an increasing number of deals involving foreign private equity firms due to the perceived limited scope for growth within a competitive domestic market. Numerous Japanese companies are looking overseas for growth opportunities, and capitalising on the network and know-how of international private equity firms has become an attractive option. For example, Permira acquired Akindo Sushiro, a sushi chain restaurant and Carlyle acquired Oyatsu Company, a Japanese snack maker, with the intention to expand overseas.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

HR, ES & ZO: Minority stake investments by private equity firms tend to be a less common feature in Japan and we observe private equity firms continuing to pursue full or majority control of the target company, which would allow them to take over management and restructure the target group in the most cost-efficient manner. Given the accessibility of debt financing and the fact that many private equity funds have extensive dry powder that they are pressurised to deploy, we do not tend to see deals involving a partnership of two or more private equity firms. However, we do see some joint ventures in which private equity firms team up with strategic buyers or trading houses to benefit from such JV partners' manufacturing or distribution channels. An example of such a joint venture is Bain Capital's sale of a 49.9 per cent stake in Japanese telemarketing firm Bellsystem24 Holdings to Tokyo-based trading house Itochu Corp.

GTDT: What were the recent keynote deals? And what made them stand out?

HR, ES & ZO: One recent keynote deal is KKR's acquisition of Panasonic Corporation's health-care unit for an equity value of approximately ¥165 billion, with KKR and Panasonic owning 80 per cent and 20 per cent of Panasonic Healthcare respectively. This deal is significant because it was KKR's largest ever buyout in Japan and it was said to be the first time a leading conglomerate like Panasonic had sold off a profitable (albeit non-core) business to a foreign private equity investor.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

HR, ES & ZO: The majority of private equity M&A tends to be inward facing. However, large/mid-cap companies and private equity backed businesses are actively seeking to access international markets, especially those emerging economies experiencing high growth, such as Africa, China and South East Asia. Some good examples are cited in our first response above. Japanese companies and private equity funds with relatively significant war chests are also being challenged to improve shareholder value and with Japan being a mature market with slower domestic growth, overseas acquisitions are increasingly viewed as a preferable route to generate such value.

Typical challenges faced by legal advisers and companies in Japan on a multi-jurisdictional deal include the lack of familiarity with foreign law concepts, practices and the political and regulatory landscape. Therefore, international and local law expertise is essential to overcome such challenges and to close cross-border transactions successfully. Having a global network of offices and the ability to leverage on the experience, know-how and resource of our international and local lawyers equips us to deliver the right advice to our clients in an efficient and timely manner.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

HR, ES & ZO: The most commonly used source of financing for leveraged buyout transactions is bank loans. They tend to take the form of syndicated loans and often constitute term loan A (amortising tranche) and term loan B (bullet tranche) for the consideration of the acquisition and revolving credit facility for the working capital.

In terms of the availability of debt financing, there are large numbers of domestic banks that are willing to lend on leveraged buyout deals, and senior loans are usually arranged by one or more of the Japanese megabanks, namely BTMU, Mizuho and SMBC. In recent years, competition among these banks has become even more intense and private equity firms are benefiting from lower interest rates and fees and higher leverage. However, the covenants pertaining to such loans tend to be more restrictive when compared against Term Loans B and the high-yield bond markets in the US and Europe, and in the form of maintenance test rather than incurrence test.

Private equity firms also benefit from the competitive bank loan market due to easier access to refinance and recapitalisation. When a private equity sponsor cannot obtain sufficient debt financing from senior lenders, mezzanine finance is an alternative option and a frequent source of mezzanine finance is subordinated loans and preferred shares.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

HR, ES & ZO: The Tokyo Stock Exchange introduced the JPX-Nikkei Index 400 in January 2014. This new stock price index is generally scored by quantitative measurements such as three-year average return on equity, three-year cumulative operating profit and market capitalisation, and the score may be raised if a company appoints two or more independent outside directors. This index has also put the efficiency and corporate governance policies of Japanese companies in the spotlight and this increased scrutiny may pave the way for more restructurings.

The bill to amend the Companies Act was passed in June 2014 and will become effective in 2015. The Act will introduce a cash-out system whereby a shareholder holding 90 per cent or more of the voting rights of a company is entitled to buy out all shares, stock acquisition rights and bonds with stock acquisition rights held by the minority shareholders without passing a resolution at a shareholders' meeting. This is expected to provide more flexibility than the prevailing method to achieve squeeze-out of minority shareholders in the structuring of going-private transactions of listed companies by the private equity funds.

Abenomics has also had an impact on the Japanese private equity industry. The government has increased money supply to stimulate the economy and as a result, greater assistance has been provided to Japanese companies by so-called governmental funds (*kansei* funds) using public funds, such as the Innovation Network Corporation of Japan and the Regional Economy Vitalisation Corporation of Japan, and venture capital funds managed by national universities. Accordingly, the social compartmentalisation and/or cooperation between these governmental funds and the private sector funds seems to have become a critical issue. Furthermore, as Japanese banks have been struggling to manage excess funds due to the lower interest rates and surplus cash in the domestic market, alternative investments are increasingly viewed as reasonable investments. It is also reported that the Government Pension Investment Fund (GPIF), which has traditionally invested in assets such as Japanese government bonds, equities and corporate bonds, has changed its investment policy to expand its investment portfolio into alternative asset classes, such as REITs, private equity funds, infrastructure investment funds and commodity trading. As GPIF's operating assets are ¥120 trillion (which is approximately seven times as much as California Public Employees' Retirement System, the largest public pension fund in the US), even just 1 per cent of their portfolio may have a significant impact on the market. While the timing and scope of GPIF's investments in private equity remains encased in mystery, GPIF had announced in February 2014 that it would invest up to US$2.7 billion in infrastructure projects over the next five years with several other pension funds.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

HR, ES & ZO: Private equity has typically faced resistance in Japan for a few key reasons: there is a general belief that private equity houses are all too willing to lay off employees and that Japanese management prefers to retain ownership and control. As noted in our first response, there are several factors that could have the effect of reversing the trend and encouraging more private equity buyouts. However, government-backed funds or trading companies may remain as preferred acquirers as they are more likely to be deemed to be motivated by long-term growth.

Shareholder activism is gaining momentum in Japan in part due to the introduction of the JPX-Nikkei Index 400 (as described above) and increasing scrutiny and demand for accountability. A high-profile example of a foreign activist investor and resistance to a private equity buyout by a target board is the hostile takeover bid against Seibu Holdings Inc by a US private equity firm, Cerberus Capital Management LP. Cerberus demanded higher returns and tried but failed to take control of Seibu's board in 2013. Another example is Third Point LLC, a US hedge fund, which demanded restructuring of Sony Corporation in 2013.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

HR, ES & ZO: Trade sales to strategic buyers remain the preferred exit route for private equity funds to exit their investments, representing more than half of all exit deals. This is due to the keen expansionary interests of international conglomerates who are under pressure to meet their shareholders' high growth expectations and the fact that target companies often tend to be too small and the IPO process being much too complicated and time-consuming to make IPO a viable exit option. Secondary buyouts to other private equity firms are also commonplace as funds are continuously seeking to make investments in a market with a scarcity of attractive or suitable proprietary deals. Although there have been fewer IPO exits, the market condition has improved as a result of Abenomics and this is likely to lead to an increase of IPO exits in the coming year.

A couple of notable trade sale exits include KKR's sale of Japanese recruitment services provider Intelligence Holdings to Temp Holdings for ¥68 billion, which is double the amount paid by KKR for the temporary staffing agency three years ago, and Bain's sale of a 75 per cent stake in household name Domino's Pizza Japan to Domino's Australia for ¥12 billion.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

HR, ES & ZO: Investors have shown a large appetite for investments into Asia, and Asia-focused fundraising has dominated aggregate capital raised by private equity funds globally (75 per cent in 2013, according to Preqin). It is reported that the average fund size of Asia-focused private equity vehicles is at its highest levels and is almost double the size of funds in 2009. Some of the established private equity funds, such as KKR, Permira and CVC have also recently raised multibillion-dollar funds. Coupled with the prevailing trend among investors to expand asset allocation beyond Japanese government bonds and equities, to alternative products including private equity funds, the current market can be said to favour sponsors. As we continue to see strong exit activity, a high proportion of capital that is bound up in mature investments and the demands of investors to reinvest their private equity returns, we expect fundraising levels to remain strong in the coming year. Having said that, Japanese investors are generally cautious and careful investors and will take the time to conduct a thorough due diligence of the funds and their managers prior to investing, which might in turn negate any notions of a sponsor favour market.

"Government-backed funds or trading companies may remain as preferred acquirers as they are more likely to be deemed to be motivated by long-term growth."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Given the economically conducive climate for private equity in Japan – a favourable set of economic policies, large underperforming companies, mid-cap companies with overseas growth aspirations, a transparent legal system, availability of cheap capital – it is noteworthy that the value of private equity buyouts in Japan has remained so small relative to global activity. As the third-largest economy in the world, Japan could potentially be one of the largest untapped markets in Asia. However, the pervading culture of ambivalence towards private equity could potentially continue to hinder such investments and developments in the near future.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

First, your legal counsel should have a deep knowledge of the private equity practice, both locally and internationally, in order to advise on the peculiarities of the corporate culture in Japan and the practices of overseas private equity firms. Second, complex transactions tend to feature cross-border elements and it is crucial to employ a law firm with a global network and local offices in the key jurisdictions concerned. Third, choose an experienced counsel who understands your business and motivations and one who you can trust to provide you with not just solid legal advice, but sensible commercial advice as well.

What is the most interesting or unusual matter you have recently worked on, and why?

We advised LIXIL and the Development Bank of Japan on the €3.059 billion acquisition of 87.5 per cent of GROHE from TPG and Credit Suisse PE. This was the largest investment by a Japanese corporate into Germany and the second-largest Japanese outbound deal of 2013, involving over 18 of our offices globally. This deal was also awarded the best cross-border M&A deal at the FinanceAsia Japan Achievement Awards in 2013/2014. This deal is unique as Japanese megabanks (in this case, BTMU, Mizuho and SMBC) rarely provide financing, by way of a non-recourse loan, for an acquisition of overseas assets.

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GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

HR, ES & ZO: Private equity funds in Japan are typically formed as Japanese domestic limited partnerships (the Japanese LP) under the Limited Partnership Act for Investment of Japan (the Limited Partnership Act). The Japanese LP is created by executing a limited partnership agreement between a general partner as a fund manager and limited partners as investors. Thanks to the Ministry of Economy, Trade and Industry of Japan, which published a model form of the limited partnership agreement, it is relatively easy to set up a Japanese LP within a few weeks.

However, one of the challenges of this structure is cross-border investment. The Limited Partnership Act restricts the Japanese LP from investing more than 50 per cent of fund assets in equities issued by foreign companies, because the original intention of the Act was to increase the number of private equity funds for the growth of Japanese small and medium-sized businesses. Although such Japanese LPs are even used for cross-border investments now, such restriction still applies.

Japanese investors also expect that the general partner will have an appropriate investment management licence. In a global fund practice, a common structure of a limited partnership is that its general partner is formed as an SPV and its fund management duties are delegated to a fund management team which operates in a separate investment management company. The fund management team will benefit from such a structure as it will not be subject to the general liability of the general partner for any third-party creditor of the limited partnership. In Japan, however, the regulations governing Japanese LPs and general market practice may not permit such a management structure with a limited recourse of liability. A foreign manager with a Japanese-based private equity fund will encounter such differences of market practice and may regard it as a legal concern.

If a private equity fund intends to receive funding from non-Japanese investors, the fund may be created as a foreign limited partnership in Cayman, Delaware or Singapore, and in some cases, as a parallel fund of the Japanese LP, which has Japanese investors. However, if both the Japanese LP and foreign limited partnership are operated under a parallel fund structure (ie, joint managers applying the same investment strategies to both partnerships), practically speaking, the restrictions applicable to Japanese LPs as set out above will also apply to the foreign limited partnership.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

HR, ES & ZO: In Japan, the Financial Instruments and Exchange Law (FIEL), which took effect in September 2007, regulates various aspects of private equity funds, including their management and fundraising. Generally speaking, private equity sponsors are required to obtain an investment management licence under the FIEL unless it falls within certain limited exemptions, for example, if its investors are qualified institutional investors (QIIs) or quasi-QIIs.

Private equity sponsors must also comply with the reporting and disclosure requirements set out under the FIEL, which was especially designed to protect Japanese investors. Therefore, funds with Japanese investors are generally subject to greater scrutiny in connection with licensing than funds that restrict their investors to non-Japanese. In practice, however, supervision over capital-raising activities is relatively lax in Japan and it is possible to structure vehicles that require limited or no disclosure if the fundraising is a private placement subject to certain exemption requirements. The day-to-day business and conduct of private equity sponsors are not generally affected by the regulator's supervision. In practice, their business and conduct will be regulated by the power balance and relationship between the sponsor and its investors and this is reflected in the investment agreements.

In recent years, however, the Japanese Diet has proposed amending the FIEL and the Investment Trust and Investment Corporation Act to impose additional regulations on the asset management industry in response to the insider trading scandals upon public stock offerings and the AIJ scandal, which came to light in 2012. The AIJ scandal involved the loss of a large amount of pension fund assets that were managed by AIJ Investment Advisors Co Ltd (AIJ), a Tokyo-based advisory company. It was discovered that AIJ had been falsifying performance records on roughly ¥200 billion (US$2.4 billion) in pension money. These additional regulations might include diversification investment rules and restrictions on derivatives risk quantity, both of which are highly controversial and are likely to have a significant impact on investment management firms operating in Japan.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

HR, ES & ZO: Over 90 per cent of the total funds market in Japan constitutes domestic funds and since 2007, 50 per cent of this has been invested overseas by Japanese funds that are likely to have appointed foreign managers to manage such foreign investments. The AIFMD has had an impact on the selection of such foreign managers. On or before the implementation of the AIFMD, a number of Japanese funds were also required to restructure or review their fund structure in accordance with the AIFMD requirements. Despite the monopoly of the Japanese domestic fund as a fund domicile, the AIFMD, although it is EU legislation, has had an impact on the Japanese fund market.

Asian fund managers, including Japanese managers, have to consider the effect of the AIFMD on their fundraising. The managers must set appropriate limitations in their choice of domicile of a fund and/or SPV and the target investors' location in order to avoid the application of the AIFMD. Such limitations have restricted the selection of fund structures and managers have lost their freedom to expand their pool of targeted investors in Europe. Japanese managers who had selected European funds such as Luxembourg or Irish funds have consequently shifted to other jurisdictions, such as the Cayman Islands or Singapore. Similarly, more new funds have been launched outside Europe and existing funds have been restructured to move their domiciles outside Europe.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

HR, ES & ZO: The proportion of private equity deals in North America and Europe is likely to continue to dominate. However, given the fierce competition among private equity sponsors in these mature markets, strengthening stock markets and high seller valuation expectations, many sponsors are looking to Asia for growth opportunities and are increasingly active in developing their Asian-based funds. Correspondingly, Japanese investors, including private equity sponsors, trading houses and government-backed funds, are also seeking access to higher-yielding investment opportunities beyond Japan.

Japan is unlikely to see any major changes or development in the private equity industry in the coming year. However, investors will continue to place pressure upon the sponsors to deploy their capital and if purchase price multiples of targets are reasonable, transactions are likely to crystallise. In this regard, private equity sponsors may focus their investments on the lower end of the market where there are greater opportunities for proprietary deals and particular attention may be paid to the technology industry, temporary staffing industry and the health-care sector in Japan given its ageing population and rising demand for such services. However, private equity funds will continue to face stiff competition in the form of strategic buyers, trading houses, government-backed funds and overvalued targets.

Kyungseok Kim

PRIVATE EQUITY IN KOREA

Kyungseok Kim is counsel at Linklaters, which has advised on a number of major private equity sector deals involving Korean inbound and outbound as well as global M&A deals.

The firm's recent transactions include advising a large Canadian institutional investor coinvesting with MBK Partners, a Korean private equity fund, on the US$1.65 billion purchase of ING's Korean life insurance business; a consortium of investors including Affinity Equity Partners, Baring Private Equity, the Government of Singapore Investment Corporation and IMM Private Equity in its acquisition of US$1.1 billion stake in Kyobo Life Insurance from Daewoo International Corp; and Standard Chartered Private Equity on its acquisition of 95 per cent of the issued and outstanding share capital in Smoothie King Systems, Inc.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Kyungseok Kim: Local private equity firms are becoming more aggressive in their investments. Minority investments have been the prime focus for local private equity firms in Korea in general; however, decelerating economic growth, succession issues and regulatory restrictions on IPOs have cultured a more aggressive environment for local private equity firms, which have gradually been shifting their focus from minority-stake to control-style deals. Still, even though trends show increased activity in capitalising on buyout opportunities, many industry professionals believe minority investments will continue to dominate the market as corporate activity of Korean conglomerates is characteristically very conservative in selling controlling stakes.

Also, investments by local private equity firms have historically been concentrated on local corporations, but recent trends have shown such firms have also been interested in investing abroad, creating a more diversified portfolio for local private equity firms.

Furthermore, global and regional private equity firms are showing increased interest in the Korean market with the decrease in general deal volume in the other Asia-Pacific region. It is also attractive because of high liquidity and low interest rates for debt financing.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

KK: Minority investments have been the prime focus for local private equity firms in Korea in general; however, decelerating economic growth, succession issues and regulatory restrictions on IPOs have created a more aggressive environment for local private equity firms, which have gradually been shifting their focus from minority-stake to control-style deals. Still, even though trends show increased activity in capitalising on buyout opportunities, many industry professionals believe minority investments will continue to dominate the market as corporate activity of Korean conglomerates is characteristically very conservative in selling controlling stakes.

Also, private investment activity has traditionally been split into two categories in Korea, with venture capital funds investing in start-up businesses and private equity firms investing in more established businesses. Recently, a more flexible approach in investments has softened this split in investment activity.

GTDT: What were the recent keynote deals? And what made them stand out?

KK: The sale of Oriental Brewery was unique because the exit for the private equity investor was made via the exercise of the call-option by the original seller (ie, buyback transaction).

The sale of ADT Caps by Tyco International also stood out. Given the size of the transaction, it attracted the interest of a sizeable number of global and regional buyout funds.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

KK: Private equity M&A does not tend to be cross-border.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

KK: The amount of debt financing in Korea is usually the same, at most, or equal to equity. Such debt financing is usually in the form of commercial loans that include term loan and revolving credit

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The private equity market in Korea has a relatively short history, but is growing at a very rapid rate. It is an extremely active market for one that comprises a small circle of market players and where dealmaking is determined by having relations within the rather exclusive network.

Recent trends in the market also lend to interesting transactions for the practice as PEFs are becoming more and more aggressive in their investments. Investments by domestic private equity firms have historically been concentrated on local corporations, but more recently such firms have also been interested in investing abroad, creating a more diversified portfolio for local private equity firms. Furthermore, the significance of the Korean markets to global private equity firms is becoming increasingly more important with the decrease in deal volume in the Asia-Pacific region. Also, the market has shown increased activity in capitalising on buyout opportunities even though more conventionally, minority investments have been the prime focus for private equity firms in Korea.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

In addition to technical skills, knowledge of the local market and market participants is crucial in dealmaking. Understanding the key drivers and strategic challenges of the client's business and seeing from the client's perspective allows for innovative and efficient performance when advising and successfully executing any transaction.

What is the most interesting or unusual matter you have recently worked on, and why?

The ADT Caps transaction. We assisted our client in reaching out to the seller before seller decided to sell the asset and helped our client to put together a consortium for the bid. We were integral to the inception of the deal.

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facilities. Recently, a favourable leveraging environment has fostered mezzanine financing, such as through life insurance and pension funds in form or subordinate loans, as a source of financing for transactions. Korean regulators have relaxed the PEF regime under the FSCMA, introducing an amendment on 29 August 2013 which, among other things, loosens investment restrictions imposed on private equity firms by clearly defining the extent to which mezzanine financing can be utilised.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

KK: There have been no significant changes to the legal framework governing private equity firms since its inception in 2004. However, there has been some relaxation of the regime (as mentioned above) due to rapid growth of the Korean PEF market.

Nevertheless, the policy landscape is still a rigid one, with high scrutiny over fiduciary duty and strict enforcement of tax laws. Local private equity firms may request to be treated as a tax pass-through entity, in which case there is no income tax at the PEF level; however, if not approved, the fund itself, rather than the investors, is treated as the stand-alone legal entity liable for tax. Income is normally subject to Korean withholding tax (22 per cent) unless it is reduced through applicable tax treaties between Korea and the country where the investment vehicle is established. Korean tax authorities consider various factors such as physical substance, corporate governance, and financial implications when determining beneficial ownership, which at times may be denied.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

KK: Policymakers and the public generally display negative sentiment towards private equity as 'repercussions' of private equity activity are felt throughout the corporate ladder, such as through restructuring, lay-offs and returns harboured offshore.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

KK: Trade sales are the most common exits sought by and available to private equity firms in Korea as this method generates the greatest return for investors. IPOs as exit strategies are rare, but secondary buyouts are gaining interest, especially with regard to offshore private equity firms.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

KK: Fundraising in Korea has experienced an upward trend with the total number of private equity firms recording a growth of 439 per cent from 2007 to 2013 and total commitment recording a growth of 389 per cent in the same period. Such growth is expected to continue as more general partners, corporates and wealthy individuals become more exposed to the private equity market.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

KK: While registration of foreign global private equity firms is not required in Korea, local private equity firms are subject to registration and regulation (as mentioned above). While these supervisory measures have little impact on day-to-day business, regulatory monitoring does impact the investment activity of local private equity firms.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

KK: Interest income as well as capital gains on transfer of equity of domestic lenders is included in ordinary income and is therefore subject to a corporate tax rate of 11 to 24 per cent. Interest income of offshore lenders is subject to a withholding tax of 22 per cent (subject to a reduced tax under an applicable tax treaty). Capital gains on transfer of equity of an offshore lender is subject to capital gains tax at the lower of 22 per cent of capital gains and 11 per cent of sales proceeds. Transfers of Korean shares, owned by a foreign entity, within the Korean market are exempt from capital gains tax if (i) the shares are listed, (ii) the shares are traded through stock exchanges or KOSDAQ, and (iii) the foreign participation has not exceeded 25 per cent during the five-year period prior to the transfer. A securities transaction tax of 0.3 to 0.5 per cent is also imposed on sales proceeds.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

KK: As Korean conglomerates continue to undertake corporate restructuring, there will continue to be minority investment opportunities as well as selective buyout opportunities in Korea.

"As Korean conglomerates continue to undertake corporate restructuring, there will continue to be minority investment opportunities and selective buyout opportunities in Korea."

Luis Burgueño

Andrés Nieto

PRIVATE EQUITY IN MEXICO

Luis Burgueño is a partner at Von Wobeser y Sierra with more than 16 years of experience advising global leading corporations that are part of the Dow Jones, S&P, DAX, Nikkei, Bolsa Mexicana de Valores, the Fortune 500 and Forbes 100. His practice covers banking and finance; corporate, structured and project finance; energy and natural resources; foreign investment; M&A; joint ventures; and securities and capital markets.

Luis has been involved in a number of matters related to transnational companies in Mexico, Latin America and the Caribbean.

Andrés Nieto is a partner at Von Wobeser y Sierra SC with more than 15 years' professional experience in Mexico, New York and Latin America. His clients appear in Fortune 50 and Fortune 500, as well as the Dow Jones, S&P 500, DAX and the Nikkei.

He has a multidisciplinary practice, with an emphasis on cross-border transactions, which includes experience in several of the principal transactions that have taken place in Mexico and the United States in the legal areas of banking and finance, securities, corporate, M&A, as well as in risk capital transactions, private capital, structured financing, project finance and arbitration.

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GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Luis Burgueño & Andrés Nieto: We have perceived a substantial increase in the levels of activity in both firm buyouts and investments during the last 12 to 18 months, although admittedly from a small base (Mexico's private equity sector is still underdeveloped compared to other countries, even in Latin America). Private equity firms have focused on mid-market transactions, typically trying to identify small and medium-sized Mexican firms with growth potential. Public-to-private transactions are very limited in Mexico, as public companies are typically controlled by a family of tightly held groups thus limiting public M&A activity.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

LB & AN: Private equity in Mexico has traditionally focused on five areas: real estate, technology, telecoms and media, financial services, and wholesale and retail trade. Recently, however, we have seen a significant increase in activity related to natural resources (mining and renewable energy), infrastructure, auto parts, health-care services, and oil and gas related industries. In this latter area, we have seen several transactions ranging from tens to hundreds of millions of dollars of private equity funds investing in companies that supply the oil industry, mostly Pemex, as the private equity funds value the target's experience in selling to the government and seek to establish a presence in advance of the expected energy sector boom.

As to the types of investments and transactions, private equity firms continue to pursue straight buyouts as the preferred acquisition structure (coupled with earn-out mechanisms to reduce risk by maintaining sellers' committed to the business for three to five years). Private equity firms have been more open to minority stake acquisitions recently, but straight buyouts as preferred. There have been several success stories of partnerships at different stages of the firm's lifecycle (Cinemex, Genomma Lab), but local firms are still reluctant to accept private equity firms as they are uncertain about the value added by private equity investment and fears of losing control over the company.

GTDT: What were the recent keynote deals? And what made them stand out?

LB & AN: There have been few landmark or particularly novel deals in recent years. The industry had a very good year in 2013 in terms of levels of activity and transaction volume, but we cannot identify a particular keynote deal.

Two of the most significant transactions, because they may be indicative of a huge influx of deals into the energy sectors, are: (i) the (Swiss)

"Mexican firms are quite often targeted because of their potential to become headquarters for future expansion into Latin American countries."

Partners Group's acquisition of a majority stake in Fermaca, an energy projects and natural gas pipeline operator and (ii) Palladium Equity Partners' acquisition of Q'Max, an oil field services company with operations in Latin and North America, of which Mexico represented a substantial portion. Chicago-based Madison Dearborn Partners' acquisition of Centennial Tower, a telecoms infrastructure operator with assets in Mexico, Colombia and Brazil is also very significant, as it signals a potential influx of capital into the recently reformed telecommunications sector in Mexico. The IPO of Wamex's backed Hoteles City Express also stands out, mostly because it was a going-public exit (one of the very few private equity backed IPOs ever in Mexico).

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

LB & AN: Many private equity M&A deals are cross-border, either because the private equity firm is a foreign firm acquiring a Mexican target, or because a private equity firm acquires a foreign company with a substantial presence in Mexico (ie, when a target is a global or regional company that has operations in Mexico). Also, Mexican firms are quite often targeted because of their potential to become headquarters for future expansion into Latin American countries.

Typically, multi-jurisdictional deals present unique challenges for Mexican counsel, as it is necessary to know and understand the foreign private equity firm's practices and concerns and translate them into structures and legal covenants that are valid and enforceable in Mexico but at the same time replicate the standard structures and documents that are familiar to investors. Of particular importance are tax planning, Mexican labour laws, local regulations (in regulated industries deals) and exit opportunities, among other things.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

LB & AN: The landscape for financing of acquisitions remains rather stable without notable developments in the last year or so. The Mexican economy is pretty stable (albeit growing slowly) and the Mexican legal regime is very flexible and pretty standard, so financing of transactions is rather straightforward in terms of structuring and implementation.

It has been pointed out that, unlike in developed markets where leverage is gamely available for private equity deals, the lack of specialised acquisition finance teams in Mexico's banking and financial institutions limits the ability for private equity funds to leverage their deals.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

LB & AN: There have been several changes during the last few years in terms of legal and policy landscape affecting private equity funds. In the area of fundraising, for instance, certificates for capital development (CKDs) are a form of securities currently used to fund private equity funds and real estate investment trusts (REITS or FIBRAS), which allow private pension funds (Afores) to invest a percentage of their assets therein. In 2012, regulations were made more flexible to allow for the issuance of CKDs that are not totally pre-funded (currently, CKDs are required to fund only 20 per cent of their total commitments before issuance, while the rest can be met through capital calls).

The 2013 tax reform has also had a material impact on private equity transaction structuring and planning, as a new 10 per cent dividends tax was introduced for dividends paid to foreign shareholders. This has created particular challenges for acquisition structuring in private equity deals.

On the other hand, the 2013 constitutional reform aimed at liberalising the energy sector, followed by the 2014 enactment of secondary legislation, have created new opportunities for private equity funds, by allowing for private investment in this key sector of the Mexican economy which has historically been reserved for the government.

Finally, the recent financial and corporate reforms in 2014, aim for, among other things, a further growth and development of private investment schemes, reducing regulatory barriers and updating the legal framework.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

LB & AN: The Mexican government has a favourable attitude towards private equity firms, although no particular tax or other incentives have been established to further foster this industry.

Because most public companies are really controlled out of the stock market by a family or closely held group of owners, there are no public-to-private buyout transactions and shareholder activism plays no substantial role in Mexico.

One of the main challenges that private equity firms face in Mexico is the fact that the potential target's owners still fail to see private equity capital as a strategy for growth. Many successful companies that would benefit from capital infusion to fuel growth (in addition to management experience, world-class practices and other typical benefits from taking capital from private equity firms) are still hesitant to submit themselves to the transparency and accountability obligations that naturally result from taking a partner. Many owners of Mexican companies prefer to operate in their comfort zones rather than taking the challenge of accepting a results-oriented partner. Probably as private equity deals reach critical mass, Mexican firms will start to see private equity as a 'must-have' rather than 'nice to have' as part of their growth and, ultimately, survival strategy.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

LB & AN: Hold periods have continued to rise within various private equity portfolios, and increasing the exits remains an imperative for private equity firms and investors.

Since 2004 there have been a few exits via IPOs in Mexico. Trade sales (specifically to strategic buyers) are the most common exit route in Mexico. Albeit a preferred route for high-end operations, these businesses also function on lower levels. Usual day-to-day investment generally turns to simpler exit alternatives, where available. Leveraged buyouts, mergers, joint ventures and other simpler corporate buy-in operations offer an easy and efficient way to exit activities.

Most private equity transactions remain private, and thus it is difficult to keep track of all used exits routes. Nevertheless, one interesting exit used recently was a combination of a strategic sale (via a secondary sale) with a sale of the remaining shares via a sale back to the company itself.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

LB & AN: As the market progresses, investment opportunities require a more sophisticated take on equity. Sponsors that may add value with hands-on expertise and many other managing skills are now preferred to pure capital investments. As the markets grow, the speed at which the funds change hands is greatly accelerated and requires rapid and efficient response abilities from the managing parties.

The expansion for fundraising activities is unprecedented. Trust in alternative funding schemes has soared recently due to financial stability and increasing return rates. Financial growth and well-known successful experiences have broadened the base for private equity operations. The usual targets of private equity have expanded to incorporate a wide variety of projects. Concordantly, the possibilities for aggressive expansion in the future seem very promising.

Pursuant to data published by Ernst & Young and the Mexican Association of PE and VC Funds (AMEXCAP), since 2013 private equity firms focused on Mexico have raised more than US$7 billion from investors, an exponential growth during the last three years.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

LB & AN: It all hinges on the pre-designed structure. The key for a successful fundraising is the business proposal. Adequate risk management and adapting capabilities of the projects are key elements that engage interested participants. The goal is to convey a high success probability even when the project is only an idea.

"Mexican firms will start to see private equity as a 'must-have' rather than 'nice to have' as part of their growth and, ultimately, survival strategy."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The fact that publicly traded companies are typically controlled outside the stock market (ie, by a family or other closely held group) substantially limits public-to-private private equity deals. Mexican firms are very reluctant to give away control or even provide transparency as a condition to accept private equity. Many Mexican firms and their owners and managers lack experience in M&A transactions (ie, M&A is not perceived as an integral part of a firm's growth strategy), so deals in Mexico can move very slowly in some instances, which private equity firms may find frustrating given the fast-paced nature of their typical transactions.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Counsel should ideally have experience not only in private equity deals but also in the industry where the target operates or similar industries.
The firm should have experts in several areas of practice that are particular to Mexican law (labour, tax, environmental) and to the specific industry where the target operates (eg, energy, infrastructure, health care, telecommunications). Many boutique firms have very good transactional lawyers with experience in M&A and finance, but do not have real expertise in other areas of law that are critical to the success of the transaction.
The firm should have enough resources readily available to provide a timely response to private equity clients, for whom time is of the essence.

What is the most interesting or unusual matter you have recently worked on, and why?

Private equity firms are looking at Mexican targets as a base from which to develop their Latin American business and are interested in Mexican firms already doing business in other countries. This results in very interesting projects that involve not only Mexican operations, but also other countries in the region. We have participated in a couple of deals where we have had to lead due diligence efforts, transaction structuring and documentation involving not only Mexico but Brazil, Colombia and other jurisdictions. This has led us to develop closer working relationships with other firms in the region and has presented the challenge of having to identify and implement solutions that work not only in Mexico but in other countries as well.

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Timelines are managed according to project development. Once the design is complete, an implementation stage is entered into. Thus, all the different options must work in parallel to guarantee the success of the project. Once all the structures have rendered their profits (through testing and operation), the exit strategies bear their importance. Again, the design must consider the volatility of private equity to avoid crashing due to lack of funding or capital reimbursement. Contractually, the agreements must carefully foresee the different possibilities that may arise and clearly represent the interests of the different parties. Very basic and clear covenants are welcome when dealing with multiple parties with multiple interests. When drafting the different agreements that will regulate the relationship between the parties, the means of solving differences must be considered from the beginning. Prioritising ways that will allow for a quick and efficient resolution is a very good idea. Considering that the operations must continue even when differences arise and generate friction among the parties is paramount. Different situations must be dealt with using different dispute resolution instruments, according to the nature of the dispute. However, holding the operation of the funds intact is of utmost importance.

Different projects could face very different legal issues. For instance, many opportunities are now available for investment in energy (due to recent reforms to the legal framework). However, there is no certainty on how that sector will develop in the next few years. New legal provisions tend to generate adverse reactions in players (who generally seek to avoid risk). Granted that there is no precedent on how the authorities will react to private citizens and entities, private equity projects generally act conservatively. While the drafting of new legislation is far from sophisticated, there is also no guarantee as to how the judicial power will resolve big controversial issues.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

LB & AN: It depends. Generally speaking, there is no specific targeting of private equity sponsors. There are specific provisions in specific acts that require compliance and tax issues must be addressed carefully due to the nature of these operations. However, no specific treatment is granted to these players.

Compliance with the different legal provisions is very important. The financial players must be aware of the importance of having legal counsel for the design and review of the operations. However, the business scheme has broadened its out-take and now includes legal advisory during the implementation stages. From the point of view of supervision, there is no interruption from the authorities in the day-to-day business if careful planning and design occurred in the early stages of the project.

In other schemes, similar to a public listed corporation, an issuer of CKDs is subject to strict regulation relating to disclosure, director's duties, corporate governance and minority rights.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

LB & AN: The AIFMD had a limited impact on usual operations in Mexico. Only those operations for European fund managers that manage AIFs, AIFs established in Europe and those who market units or shares in Europe were directly affected. Thus, not all operations were affected by the AIFMD. In general terms, this instrument is seen as a good exercise to duly regulate these types of financial operations.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

LB & AN: Promotion of private equity schemes has been a priority for the Mexican government for quite some time. Since 2006, Mexico has granted benefits to trusts operating investment capital to boost investment (such as FICAPs and CKDs). As an example of this, trust operation investment activities shall not be taxed until the revenues are allotted to private hands and income tax is collected based on the receiver's status (respecting the personal tax status of the funders). These benefits somehow boosted investment and promoted the consolidation of these practices in Mexico.

Nevertheless, the most challenging issues involve strict compliance with tax requirements. To be eligible to receive the benefits, all legal requirements must be met (pursuant to Mexican tax legislation).

The tax treatment on investment schemes was frozen until November 2018. To evidence the Mexican government's willingness to open the market to new alternative schemes, tax authorities and other political forces opted to agree not to modify tax legislation. This, of course, was a bold attempt to boost confidence in the alternative investment structures and to foster the development of solid funding.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

LB & AN: The opening of the energy sector will offer very interesting opportunities for these kinds of financial structures. In the next few months we expect to see an increase in the opportunities to invest in this sector. However, we will not see the results until later. As time goes by, the understanding and progress of the sector will become more and more open to hedge capital, acting in various activities.

PRIVATE EQUITY IN THE NETHERLANDS

Arne Grimme, Ton Schutte, Paul Cronheim and Klass de Vries are partners in De Brauw's private equity group, advising private equity investors, ranging from niche funds to major European global venture capitalists, management, and senior debt and mezzanine providers. The practice advises on venture capital investments, complex leveraged buyouts, public-to-private transactions and large multi-jurisdictional transactions.

Arne Grimme advised UNIT4 on reaching an agreement with Advent International on a recommended full public offer (€1.2 billion).

Ton Schutte has handled various matters for private equity clients such as One Equity Partners, American Capital, Sun Capital Partners, Providence, CVC Capital Partners, Lindsay Goldberg, Silver Lake and Riverstone LLC. He advised Lindsay Goldberg on reaching a final agreement with Odfjell for the expansion of their terminals joint venture.

Among other high-profile deals, Paul Cronheim advised Omnicom on its proposed US$35 billion merger of equals with Publicis last year.

Klaas de Vries has handled various matters for private equity clients such as Waterland Private Equity Investments, HAL Investments, Egeria and One Equity Partners.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Arne Grimme, Ton Schutte, Paul Cronheim, Klaas de Vries: The conditions for private equity investment in the Netherlands continued to improve throughout 2013 and into 2014. This improving environment is expected to remain and generate relatively high deal activity over the next year or so. Dutch funds alone are estimated to hold approximately €10 billion of dry powder and, like foreign funds, are under pressure to put capital to work.

Many funds are still holding a substantial number of investments that are expected to be exited before long. The economic climate and, in particular, consumer confidence, is continuing to improve. Portfolio company defaults on existing loans are becoming rarer. The debt markets, including the markets for collateralised debt, have been open for quite some time, especially for high-quality assets. Interest rates are expected to remain low for some time to come. Relative optimism prevails.

At the same time stock market valuations are high and many listed business are holding considerable amounts of cash. They are buyers not sellers. Only high-quality assets are therefore brought to market and are usually immediately in demand by many private equity investors; many sale processes become highly competitive auctions. Private equity firms are struggling to find real bargains.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

AG, TC, PC, KdV: Most private equity deals are straight buyouts. Many larger businesses are cash-rich and have decent access to bank financing on competitive terms. They do not need private equity to invest and grow specific parts of their business or to execute an M&A strategy.

This may perhaps be a little different in the mid-market segment in which bank financing can be harder to arrange for higher-risk businesses. Still, minority investments or other atypical private equity investment structures are rare in the current market.

GTDT: What were the recent keynote deals? And what made them stand out?

AG, TC, PC, KdV: Advent's recent €1.2 billion public-to-private acquisition of Unit4 stands out for various reasons. First, public-to-private deals have been relatively scarce in recent years as record highs in stock markets have pushed up prices for public assets. Public-to-private transactions are more common for undervalued smaller businesses that are suffering from illiquidity or have other reasons to seek private investment. Second, this was an auction in a public market setting. Especially following a leak announcement, the deal generated interest from a considerable number of international private equity firms.


Paul Cronheim

Another public-to-private transaction of D.E Master Blenders 1753 by Joh. A. Benckiser in 2013 also stands out for its size (approximately €7 billion) and timing (only one year after the business was spun off by Sara Lee on the Dutch stock market).

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

AG, TC, PC, KdV: The larger private equity transactions tends to be cross-border. Due to the size of the Dutch consumer market, many of the larger businesses need to operate internationally. For many centuries Dutch entrepreneurs have not felt particularly constrained by the country's borders!

Advisers in the Netherlands are well prepared for this. Many international advisory firms have offices in the Netherlands. Independent Dutch firms have very strong alliances with similar firms in other countries and are used to providing a similarly seamless service. Dutch professionals speak their languages and are used to dealing with overseas clients in all time zones.

A challenge for any legal adviser is to remain cost-efficient. An area in which this is particularly relevant is legal due diligence. While still thorough, legal due diligence is increasingly focused on risk areas affecting the target business in question, rather than covering a full scope. Due diligence reporting is similarly focused ('by-exception'), reporting only on material issues that have been identified. Because many current deal are prepared for auction, often vendor due diligence reports are available to ease the process. It is key for bidders to pick and choose and top up on due diligence only in key areas.

Negotiation of warranty and indemnity in sale documentation can be arduous. Buyers need comfort on the target assets while private equity sellers need to limit possible residual liability following exit. For as long as interest rates remain low, the warranty and indemnity insurance market provides an opportunity for private equity sellers to limit their exposure to residual liability in certain exits. This may ease the negotiation process and limit execution costs.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

AG, TC, PC, KdV: Especially in medium-sized and large financings, traditional acquisition financing from bank lenders is not always available or only as bridge facility. Strong corporate borrowers may continue to draw on existing lines, but as leverage ratios in many sectors are still up, the search for alternative financing continues. Layered structures of loans and (high-yield) bond issues are quite common, as are short-term commitments with larger refinancings shortly thereafter.

As an alternative to stand-alone acquisition financing, buyers may look more towards their existing lending syndicate, adding acquisition lines and alternative (layered) structures including trade financing to their existing package rather than obtaining stand-alone acquisition financing.

We have also seen an increasing usage of vendor loan notes, also in larger transactions, although the identity and financial capabilities of the (often strategic) seller will determine whether that is an option or not.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

AG, TC, PC, KdV: Dutch corporate law has undergone significant changes over the past two years which are likely to affect private equity investors and the way in which they structure transactions.

In particular, the rules applicable to Dutch private limited liability companies (BVs) have become considerably more flexible. For example, the stringent restrictions regarding 'financial assistance' have been lifted. It may also be worth noting that companies can now adopt a one-tier structure, with executive and non-executive members on the same board. In particular, Anglo-Saxon private equity firms, which were less familiar with the role of the supervisory board in a two-tier structure, may welcome this change. It is also now possible to issue special shares that entitle the holder to give specific instructions to the management board on matters as may be agreed, or even non-voting shares. Corporate governance in Dutch holding companies can now be tailored to suit specific situations.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

AG, TC, PC, KdV: Policymakers and the public have no particular concern with private equity investors in general. Sometimes, the press and public sentiment tend to focus on private equity portfolio companies that are well-known or that are considered to have a particular public angle, and are financially suffering, such as child care (Catalpa), media (NRC) or companies such as HEMA. At the same time, however, this increased interest is usually short term.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

AG, TC, PC, KdV: Exit activity has been increasing. A number of private equity firms are making preparations for IPOs while the equity market remains favourable. Bain Capital's IPO of IMCD on Euronext Amsterdam took place in June 2014 and we expect that others will follow.

Secondary buyouts are also common. The assets that come to market are high quality and suitable for private equity investment with a proven business model and predicable cash flow. Other private equity firms need to put capital to work and, while the debt market remains favourable, they are often able to put in competitive bids. Other than for assets for which there is an obvious strategic buyer with lots of synergies, many exits will turn out to be secondary buyouts in current markets.

Waterland's exit from Intertrust was a success story. Waterland Private Equity Investments jumped on the opportunity to acquire the business from Fortis in 2009. It streamlined the business operations and executed a successful add-on acquisition of ATC, another trust service provider, in 2013. Shortly afterwards Waterland exited the investment in an auction with interest from a number of international private equity firms with Blackstone ultimately buying the business.


Klaas de Vries

"Buyers need comfort on the target assets while private equity sellers need to limit possible residual liability following exit."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The Netherlands has a very open market. So if you look at private equity investments you will see, for example, that we have the same amount of investment as Spain and Italy combined. And there is a reason for that: our open business climate. This lends itself well for Anglo-Saxon investors, for expanding to a global industry, and for internationally focused management. That's what makes private equity interesting to the Netherlands.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

You need counsel experienced with complex deals so that you can get to the heart of the matter immediately. This way you can pass over all standard stuff. There is no need to reinvent the wheel. Counsel should get 90 to 95 per cent of the deal done efficiently and quickly; once that is done, all you have to do is concentrate on the remaining 5 per cent where the difference is made and which is critical to clients in making a success of their acquisition or divestment. For all of this, counsel must have market experience. Moreover, if the target business is complex, you must choose a firm that can deliver all the relevant expertise. For example, if you do a deal in a regulated industry, you will need regulatory specialists to complement the deal team.

What is the most interesting or unusual matter you have recently worked on, and why?

There is no particular deal in the last 20 years that we would single out. It is perhaps interesting to mention a recent one. We have just finalised the sale of Nedschroef to a Chinese party, in which we were counsel for Gilde Buy Out Partners. It was special; we also represented Nedschroef in 2007, when it was still a listed company. We took care of the public-to-private, with Gilde on the other side of the table. We now represent Gilde on the subsequent exit. We enjoyed watching Nedschroef go through these phases in seven years, from public to Dutch private equity to Chinese ownership.

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GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

AG, TC, PC, KdV: The market in general tends to favour investors although the gap between funds with a success full track record and those lacking such a track record seems to widen with the latter finding it increasingly difficult to attract investors. In 2013 private equity funds and venture capital funds raised €693 million of new funds; this is a significant decline of 39 per cent relative to 2012. Before 2013, Dutch private equity funds raised €1.1 billion in 2012, €2.1 billion in 2011 and €1.1 billion in 2010. Pension funds in particular withdrew over the last three years: in 2011 they invested €456 million in investment funds, while in 2013 they invested a mere €49 million. Family offices and private individuals stayed in the market and gained market size from 20 per cent in 2011 to 41 per cent in 2013. Captive PE firms used by banks, insurers and other large institutions grew proportionally to individual PE firms from roughly 10 per cent in 2011 to 30 per cent in 2012 and have remained stable since. In 2013, Dutch private equity funds held €29.8 billion of assets under management in 2013.

GTDT: Talk us through a typical fundraising. What are the timelines, structures, and the key contractual points? What are the most significant legal issues specific to your country?

AG, TC, PC, KdV: The timeline to come to a first closing often depends on the sponsor's track record and currently ranges from six months to two years. Structures commonly used in the Netherlands are either tax transparent or opaque. Tax transparent funds are structured as limited partnerships (CVs) or funds for joint account (FGRs). Opaque funds often are structured as private companies with limited liability (BVs) or cooperative associations (Coops). Key contractual points include incentives for first closing investors, management commitment, management fee and no fault divorce. When structuring the fund as a CV, one of the legal issues that comes up relates to the limited liability of the limited partners. If the name of a limited partner is referred to in the name of the CV or if the limited partner is involved in the day-to-day management or has an dominating influence on the general partner, it becomes liable for all liabilities of the CV.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

AG, TC, PC, KdV: Managers used to be unregulated in the Netherlands if they marketed to fewer than 150 non-professional investors or if the amount paid up by each investor for that investor's interest in the fund was more than €100,000. As of 22 July 2014 managers of private equity funds must have applied for an AIFM licence. Apart from supervision by the Dutch regulator (AFM) and reporting requirements, the introduction of a depositary impacts the managers most. Sub-threshold managers (AUM below €100 million, if leveraged or AUM below €500 million, if unleveraged) typically will not opt for a licence unless they are forced to do so by their investors or in order to be able to market in Europe.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

AG, TC, PC, KdV: Until 22 July 2014 a grandfathering regime applied in the Netherlands allowing marketing to continue under the old regulatory regime if the manager had been active in the Netherlands prior to 22 July 2013. Many managers have relied on exemptions that were available under the old regime. Therefore the AIFMD will have an impact on fundraising in the Netherlands after 22 July 2014.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

AG, TC, PC, KdV: Private equity typically faces tax challenges in relation to interest deductibility, taxation of carried interest and management incentives and withholding taxes.

Until 2012, the Netherlands had a number of anti-base erosion rules aimed only against related-party debt. Recently, these anti-base erosion rules have been supplemented, and partially replaced, with new interest restrictions limiting the deductibility of 'excessive' interest on both related-party and external debt. With careful planning private equity can still achieve substantial interest deductions on shareholder loans and bank debt, but the era of near unlimited tax base erosion is certainly over.

Historically, carried interest and management incentives could often be structured to be taxed at a very low rate (1.2 per cent tax annually of the value, no tax on actual gains). Since the introduction of so-called 'lucrative interest' rules in 2009, this has changed. Generally, carried interest and management incentives are now taxed at progressive rates of up to 52 per cent, although in many cases they can be structured through an intermediate holding company to be taxed at a flat rate of 25 per cent.

International private equity investors also need to consider the mechanics of extracting profits from the Netherlands without dividend withholding tax. Typical ways to avoid dividend withholding tax include the use of a Dutch cooperative association or EU-resident entity as a holding company for the portfolio company but in recent years both Dutch and foreign tax authorities have become increasingly sensitive to the use of such entities.

We do not expect any major changes to the existing Dutch tax system in the near future, but the international debate about base erosion and profit shifting is certainly going to change the international and Dutch tax landscapes in the years ahead.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

AG, TC, PC, KdV: We expect the trends from 2013 and 2014 to continue. There is plenty of dry powder to last a while and interest rates are expected to remain low. We expect much of the M&A in the foreseeable future to be exit-driven.

"Whether Russia will be successful in its efforts to build a competitive PE market is yet to be determined"

PRIVATE EQUITY IN RUSSIA

English-qualified partners Mark Geday and Tomasz Woźniak lead Herbert Smith Freehills' Russian private equity practice. Clients in Russia include VTB Capital, the Russian Direct Investment Fund, Goldman Sachs, One Equity Partners, Baring Vostok and TPG. They advise a range of private equity players, including international PE sponsors, Russian investment groups, management teams and specialist private equity lenders.

Tomasz has been working in Russia since 2007 and has particular expertise in public and private M&A, private equity, joint ventures and initial public offerings.

Mark has significant experience dealing with all aspects of company law including M&A, disposals, reconstructions, joint ventures and fundraising. He has particular experience advising private equity, hedge fund, real estate and wealth managers and has acted as co-head of the asset management practice.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Mark Geday & Tomasz Woźniak: The Russian Federation has strong ambitions to attract foreign investment and grow a domestic PE market. In this environment, entities such as the Russian Direct Investment Fund (RDIF) and VTB Capital have been allowed to thrive and now are among the most active players in the Russian PE sector. While VTB Capital is building a good track record of exits, whether Russia will be successful in its efforts to build a competitive PE market is yet to be determined and how current events play out will be key. Whereas 2013 finished strongly and there were a number of bright spots, in terms of both new fundraising and exits achieved, what will happen in the short term is still questionable. Without doubt, PE activity in the Russian Federation has been hit recently by the faltering Russian economy, regional instability following events in Ukraine and the sanctions that have been imposed in response to these events. Regulatory uncertainty is also playing a part in the overall slowdown in PE dealmaking experienced in the first half of 2014.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

MG & TW: Buyouts (whether by management or otherwise) tend to be relatively unusual in Russia. It is more common for investors to take minority stake investments. Where control is acquired, these investments tend to be carried out by way of a consortium deal. There are a number of factors that drive this but a key driver is financing. As with any jurisdiction, clubbing together means that investors can access larger deals but this increased financial resource is particularly relevant in the Russian Federation where deals tend not to involve debt financing.

Aside from financing issues, for various reasons, foreign investors often seek out local investors to partner with because Russia has a reputation as a jurisdiction in which it is desirable to have a strong local partner in order to achieve successful business operations. A local partner brings local knowledge and connections that can be indispensable for foreign investors, who are unfamiliar with the Russian regulatory system and lack relations with the Russian authorities. Partnering with a local PE house may make obtaining investment committee consent easier, as comfort is taken from the experience, expertise and influence of the domestic partner. On the flip side, for domestic investors involving an international partner has a certain cachet that can be of particular leverage when trying to negotiate an exit. In addition, international investors can bring a greater depth of deal experience and sector knowledge to what is still a relatively immature PE market.

GTDT: What were the recent keynote deals? And what made them stand out?

MG & TW: Although recently overall deal levels have been lower than hoped, key market players are continuing to be involved in significant PE transactions. In a muted IPO exit market, the IPOs of both Lenta and Tinkoff Credit Systems stand out as examples of successfully negotiated exits for PE investors, as we mention later.

RDIF has been involved in establishing both joint investment platforms with foreign sovereign wealth funds and traditional style co-investments with other PE players (including its joint investment with Baring Vostok Capital Partners in Tigers Realm Coal Ltd and with EBRD in Cotton Way).

LetterOne, which is the investment vehicle of the Alfa Group shareholders founded in 2013, announced its first deal in March this year with the purchase of the oil and gas subdivision of RWE, the German utility company. This is a rare example of outbound PE investment by a Russian PE investor.

GTDT: Does private equity M&A tend to be cross-border? Tells us about some of the typical challenges legal advisers in your jurisdictions face in a multi-jurisdictional deal.

MG & TW: Most PE deals relate to Russian targets and given the current political, economic and regulatory conditions in Russia and the novelty of Russia as a jurisdiction attracting PE investment, foreign investors are still in the minority. Outbound investment by Russian PE sponsors in overseas investment opportunities is rare. As noted earlier, the LetterOne acquisition of the RWE subsidiary is an unusual example of such investment. The bulk of the transactions therefore involve the acquisition of Russian assets by Russian bidders. These deals have, however, traditionally had a strong cross-border element since, as a result of various tax, regulatory and legal drivers, the deals will be structured using offshore acquisition vehicles, although we mention later some of the forthcoming challenges these structures may face.

A cross-border transaction in any jurisdiction will present complexities not present on a purely domestic deal and Russia is no exception to this general position. Typical challenges to be dealt with by legal advisers working on cross-border transactions in Russia include the complex regulatory landscape and marrying the applicable requirements of the Russian legal systems with those of the chosen governing law of the transaction; the lack of established market practice and relatively few precedent deals against which to benchmark transactions; the related lack of experience of PE dealmaking among the business community; and managing relations with the Russian regulators and government, particularly where the transaction involves entities operating in politically or commercially sensitive sectors.

Russia is a market that is continuing to develop and, as its own laws are revised to include concepts that are used in other markets, we see increasing interaction between differing legal frameworks. It is key to ensure that legal advisers have a full understanding both of what the international investors expect and the features of the Russian market.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

MG & TW: The traditional heavy dependence on acquisition finance to leverage PE acquisitions is not a prevalent feature of PE investment in Russia. The significant majority of deals are equity only. That said, there are examples of state banks providing debt financing for acquisitions. Local players such as VTB Capital, Sberbank CIB and RDIF can at times offer the ability to refinance post-investment, which gives them a competitive advantage over other PE sponsors.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

MG & TW: Recent years have been marked by the desire on the part of the Russian government to make Russia more attractive to foreign investors and to support the growth of a local PE market. The Russian PE market has been transformed by the emergence of government-backed sponsors and financial institutions. In particular, RDIF was established in 2011 to make equity co-investments with major Russian and international players. Against this, however, the sanctions recently imposed will, without doubt, impact the Russian PE market.

Along with the general trend to expand and promote the Russian PE sector, there is the 'de-offshorisation' drive currently being pursued by the Russian government. A draft law is now being considered by the Russian government that will introduce controlled foreign company rules in Russia, which we talk about further below.

In addition, significant changes are being introduced in the Russian Civil Code. The amendments are designed to create certain legal instruments that are commonly used in Western jurisdictions but were previously unenforceable under Russian law. The changes that have already come into force include concepts of irrevocable powers of attorney and escrow arrangements, and allowing shareholders to choose the governing law of shareholders' agreements in respect of Russian companies. Key concepts that are now being considered include equivalents to option agreements, warranties, representations and indemnities.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

MG & TW: Contrary possibly to the experience in other jurisdictions covered by this review, the PE industry is widely supported and championed by Russian policymakers. As noted above, there is a desire to grow a local PE market and the emergence of government-backed sponsors such as VTB Capital and RDIF demonstrate the government's support for this strategic objective. In particular there have been no signs of the political or public scrutiny of the PE industry experienced in other jurisdictions. This may be in part due to the relatively low prominence and novelty of the PE industry in Russia.

There have been some examples of shareholders engaging actively in the management and governance of public listed and unlisted companies in Russia. However the prevalence of low free floats and controlling shareholders mean that it is unlikely that the levels of activist/turnaround investment experienced in the US and the UK will become a regular feature in Russia.


Tomasz Woźniak

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

MG & TW: Although a couple of significant exits have been achieved recently, overall activity levels of late have been lower than the market had hoped and the anticipated pipeline of PE exits failed to materialise in early 2014.

In the midst of this general trend, the IPO of Tinkoff Credit Systems in London in October last year and the dual London-Moscow listing by Lenta in February this year stand out. However, although these IPO exits were achieved, there was some disappointment in the market that external events distracted attention from these deals, which might otherwise have marked a shift in attempts to focus global attention on the Russian market.

The absence of a ready pool of potential PE sponsors and the current size of the market combine to result in there being no real viable secondary market through which PE investors can achieve a successful exit from investments in Russia. Given that the strategic market relies

"It is key to ensure that legal advisers have a full understanding both of what the international investors expect and the features of the Russian market."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The heavy influence of government-backed sponsors and financial institutions and the general political environment make Russia a challenging jurisdiction. When this is combined with the often novel legal issues we face in dealing with the interface between the Russian legal regime and international business practices, clients rely heavily on their lawyers to help deliver legally robust and commercial outcomes.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

1. Can counsel provide seamless advice on Russian legal, regulatory and tax issues and the legal, regulatory and tax issues across the range of other jurisdictions and governing laws involved?
2. What experience does counsel have in dealing with local counterparties and regulatory authorities?
3. Does counsel have experience of negotiating and bringing to fruition complex transactions based on practical experience across Russian and other markets?

What is the most interesting or unusual matter you have recently worked on, and why?

Acting for a consortium of private equity investors on the IPO of Tinkoff Credit Systems with whom we had worked since their earliest investments in the business combined our understanding of private equity, capital markets and the finance market to deliver one of the highest-profile IPOs in the market.

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on foreign investors who offer the most attractive terms, the current political, economic and legal climates are difficult as they are not conducive to (and in some cases, could prevent) foreign investors looking to enter the Russian market. As a result it is a challenging environment for exits by PE sponsors, in what has to date been an investment market.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

MG & TW: The Russian PE funds market is in its relative infancy. As such, there is insufficient volume to determine which side of the investment relationship the market favours. The general sentiment is one of trying to support and grow the industry as a whole, rather than favour one constituency over another.

Russian-focused PE fundraising levels recently have been relatively muted. There have been a couple of notable new funds raised (including the closing of a second PE fund by Da Vinci Capital and a US$550 million fund raised by Elbrus Capital) and there are reports of further fundraisings being targeted by entities including UFG Private Equity and Russian Partners (a subsidiary of the US firm Siguler Guff). The recent events stemming from Ukraine and the general slowing of the Russian economy are all likely to challenge fund closings.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points?

MG & TW: Russian fundraising has tended to follow the patterns and structures used elsewhere, with fund vehicles established in onshore markets such as Luxembourg or typical offshore centres such as the Cayman Islands or the Channel Islands. Luxembourg has the benefit of being an established regulated environment and having signed a recently amended double taxation treaty with Russia.

Although Cyprus was historically a key jurisdiction for investments into Russia (given the favourable terms of its double tax treaty with Russia), it was rarely used as a fund domicile, except in club or friends and family deals. Following the eurozone crisis this is even more the case, with investors looking to more traditional markets and structures.

Where investors are taking on greater portfolio risks than those in more mature markets, they want to minimise risks from using non-traditional fund vehicles. Due diligence remains key, with investors spending a great deal of time understanding the team, its governance structures and its approach to investments. This will lengthen the fundraising periods. Fund documentation will also reflect the enhanced portfolio risks in terms of the fund governance arrangements and, of course, the target returns and performance fee triggers.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

MG & TW: Private equity sponsors operating in the Russian Federation are not subject to particular, additional regulation over and above that applicable to other businesses operating in the jurisdiction. In particular there is no body, whether self-regulated or otherwise, charged with the oversight of the PE industry. However, there are still key regulatory issues which any entity operating in the Russian

Federation needs to be aware of, for example in relation to antimonopoly regulation, which falls within the remit of the Federal Antimonopoly Service (FAS).

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

MG & TW: As the Russian Federation is outside the EEA, where Russian managers are raising and marketing funds within the Russian Federation or otherwise outside the EEA, the AIFMD does not apply. To the extent that Russian managers are marketing or managing EU AIFs or marketing a non-EU AIF to EU investors, the AIFMD will be relevant due to the Directive's extraterritorial effect.

As mentioned, many onshore funds are based in Luxembourg, which offers some flexible solutions to the AIFMD including its securitisation vehicles.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

MG & TW: The Russian government is currently considering draft laws in relation to controlled foreign corporations (CFCs). Although the precise scope of the new CFC rules is yet to be settled, it is clear that the government is keen to restrict the availability of double tax treaty benefits for recipients of Russian-source passive income, where these recipients are not the beneficial owners of the income.

In parallel, the Russian Ministry of Finance (Minfin) has recently published guidance on the concept of beneficial ownership. Minfin made it clear that it views as abusive structures where income is channelled through treaty countries, and therefore benefits from reliefs available under the treaty, but the treaty vehicle proves to be a mere conduit, with the income subsequently paid on to non-treaty countries. The guidance links beneficial ownership of income with the ability to derive benefit from the income and to determine its economic fate.

These developments illustrate the trend of Russian tax authorities becoming more sophisticated and rigorous in their assessment of applications for double tax treaty relief. There will be greater examination of the substance of ownership structures and the nature of the relationship between, and the functions of, the various entities in these structures. Where entities are acting as a mere conduit or agent for the true beneficial owners, they may be disregarded for tax treaty purposes. Private equity investors need to be aware of this issue in the context of their investment structures and should seek legal advice on this development.

For PE managers themselves, there are no special rules with regard to carried interest and so many of the more complex structures seen elsewhere are not present in Russia.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

MG & TW: The market is currently in 'wait and see' mode. Much will depend on how soon the economic, political and regulatory situation in Russia and the local region stabilises and how the investment picture looks once the dust has settled. For international PE investors in particular, they will need to be confident that the valuation gap for Russian investment will narrow, something that has previously dented the enthusiasm of such investors for Russian investment opportunities.

Equally important will be the impact of the Russian government's de-offshorisation programme. This, in hand with changes to the Russian Civil Code aimed at creating a more flexible onshore legal environment, may put pressure on Russian PE investors to return capital to Russia and to invest directly in Russian companies. The traditional approach of structuring deals using overseas intermediaries noted above may now be in question as a result of this de-offshorisation drive.

How the major players in the Russian PE market respond to these economic, political and regulatory challenges will be a key factor in determining whether Russia can develop a PE market with notable scale, depth and liquidity.

PRIVATE EQUITY IN SPAIN

Christian Hoedl has been a partner in the Madrid office of Uría Menéndez since 1998. He heads the M&A and private equity practice area in Uría Menéndez. He has participated in a large number of private equity deals for national and international funds, with or without a presence in Spain, in both private and P2P deals. He has participated in most deals involving quoted companies made by private equity funds in Spain. Christian has extensive experience in M&A and joint ventures and has also advised on financing, directors' bonuses and refinancing in private equity-owned companies. He is recognised as a leading lawyer by the main international legal directories.

Diana Linage Gómez is an associate at the Madrid office of Uría Menéndez. She joined the firm in 2008. In 2013 she was seconded to the M&A department of Debevoise & Plimpton LLP in New York for eight months. Diana focuses her practice on mergers and acquisitions, private equity, financing transactions and corporate law. Diana has participated in several domestic and cross-border acquisitions, divestitures and other corporate transactions advising Spanish and foreign clients. She has extensive experience in structuring, negotiating and closing M&A deals and coordinating due diligence processes in the context of complex multi-jurisdictional transactions. She has also been involved in a number of project finance transactions.

Image: Victor Pelaez/iStock/Thinkstock

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Christian Hoedl & Diana Linage Gómez: The first half of 2013 showed, again, a significant decline in overall private equity activity following the downward trend experienced in preceding years. In contrast, there was noticeable improvement in deal activity during Q3 and Q4 of 2013 and the first half of 2014.

International investors have played a major role in the new wave of Spanish private buyout activity, particularly in large-scale transactions. On the contrary, middle-market deals continue to fall, representing around 20 per cent of total investment volume, and are mostly carried out by domestic private equity firms. The number of venture capital transactions continues to increase and they are receiving more and more attention by both domestic and international players; however, they remain a small fraction of total investment by value.

Since the summer of 2013 we have witnessed a return to bidding processes with private equity sponsors competing against strategic buyers. Despite the low market capitalisation of many listed companies in recent years, no public-to-private deal was completed in 2013. In light of rallying stock markets, the best time for P2Ps may be behind us. Divestments continued to increase in the first half of 2014 and we have seen many dual-track processes (such as Applus+ and ONO). Exits through IPOs have re-emerged as a credible alternative to trade sales and secondary buyouts following the significant improvement in Spain's stock market.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

CH & DLG: Although minority investments by private equity firms continue to be the exception, we have seen sporadic examples in recent years, including Advent's investment in Maxam and the more recent investment of Eurazeo in Spanish clothing brand Desigual. PIPE investments and partnerships with strategic investors remain rare in Spain. In contrast, build-up/bolt-on transactions and portfolio company investments are common.

Distressed deals still represent a significant portion of Spanish deals, not only in real estate assets but also in non-performing loan portfolios and corporate debt. We have also recently witnessed creative loan-to-own and similar strategies and direct lending by private equity sponsors.

GTDT: What were the recent keynote deals? And what made them stand out?

CH & DLG: As keynote buyout deals we would mention the sale of ONO by various international private equity sponsors to Vodafone, Carlyle's divestment from Applus+, investments by CVC and the sale of Befesa.

The sale of ONO was completed in the first half of 2014. The €7.2 billion transaction valued ONO at 10.5 times EBITDA, higher than the recent average valuations of any other European cable operators. Another relevant transaction was the IPO of Applus+. Carlyle had been running a dual-track process with a number of private equity sponsors and strategic buyers competing against an IPO alternative. Applus+ ultimately went public, delivering an €800 million payout to its owners. CVC has also been an active international player in Spain. The takeover bid for Deoleo, at a price per share under the capitalisation price, also included a refinancing plan by CVC. The private equity sponsor also acquired Doughty Hanson's stake in Grupo Hospitalario Quirón and subsequently merged it with another portfolio company, IDC Salud, creating the largest private health group in Spain. Last, the acquisition of Befesa by Triton Partners from Abengoa in a deal valued at approximately €1.08 billion was another notable transaction in 2013. The deal included Triton's assumption of Befesa's debt and a creative price-setting mechanism.

In terms of distressed M&A, the trend of investments in Spanish performing and non-performing loans, servicers and other distressed assets (mainly by former savings banks or by banks seeking to reduce exposure to these assets) continued in 2013 and 2014. Noteworthy transactions include the acquisition of EVO Bank by Apollo, the buyout of Santander Asset Management by Warburg Pincus and General Atlantic, Cerberus' acquisition of Bankia Habitat and the investment of TPG Capital in Servihabitat.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

CH & DLG: Investment in Spain by international private equity sponsors is robust, particularly in highly internationalised Spanish-based companies with interests in multiple jurisdictions, mainly in Latin America, but also in the rest of Europe and Asia. As a consequence, a significant percentage of Spanish M&A deals are indeed cross-border. The appetite for cross-border M&A is expected to increase, as private equity sponsors and strategic investors are now willing to spend the dry powder accumulated during the global financial crisis on internationally diversified Spanish target companies.

Challenges for legal advisers arising from multi-jurisdictional transactions in Spain are no different from those faced in other countries. Transaction management is one of the key issues in cross-border M&A, as coordination is required among multiple teams of foreign lawyers performing due diligence and legal analysis across many jurisdictions. Cross-border transactions also affect the sale and purchase agreement, which needs to address specific local concerns in terms of conveyance, R&Ws, liability, etc. We have also seen increasing concern for compliance matters, which requires allocating extensive legal resources to the deal in various jurisdictions. Last, in terms of acquisition finance we must coordinate the local security package with the law applicable to the main financing agreement.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

CH & DLG: Limited credit has been one of the biggest concerns in Spain in recent years, as the range of financing products available to borrowers has been extremely limited and lending entities imposed tough lending conditions, strict financial covenants, and high interest rates.

The credit market has significantly improved in the first half of 2014. Domestic and international banks are once again prepared to finance leveraged buyouts and even to re-leverage deals that were financed exclusively with equity during the financial crisis. These recapitalisation deals have become a credible alternative to divestments for private equity sponsors (often in triple-track transactions).

Besides the traditional banking financing, other sources of financing are regaining importance in the Spanish market, such as high-yield and corporate bonds, direct lending, mezzanine financing, uni-tranche and PIK and equity-like facilities. Financial covenants imposed by credit entities also tend to be less stringent than in previous years.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

CH & DLG: The implementation in Spain of the AIFMD (Directive 2011/61/EU on Alternative Investment Fund Managers) remains pending. The latest draft law on private equity and alternative investment funds was released only recently and, if approved by Parliament, will change the entire legal framework for venture capital and private equity and will have a major impact on such aspects as reporting obligations, restrictions on asset stripping and the requirement to designate depositaries.

Recently enacted tax rules and specific rulings by Spanish courts and tax authorities have also had a significant impact on the structuring of private equity transactions in Spain and, in particular, on the debt pushdown. The thin capitalisation rule has been replaced by a general restriction on the deductibility of financing expenses: net financing expenses exceeding 30 per cent of operating profit in a given tax year are non-deductible. Interest accruing on intra-group indebtedness granted to finance the acquisition of shares by another group company is no longer deductible unless the taxpayer evidences that there are valid business reasons for the transaction. Additionally, the tax deductibility of goodwill derived from the acquisition of a business through a merger or spin-off has been temporarily reduced from 5 to 1 per cent per year.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

CH & DLG: Private equity in Spain is viewed positively by the public in general and is increasingly seen as a catalyst for economic growth. Excluding the insolvency of Orizonia, there have been no major insolvency proceedings of private equity backed companies during the recent years of economic hardship in Spain, which undoubtedly contributes to avoiding the criticism that has arisen in other countries on private equity.

Public authorities are also taking measures to promote private equity in Spain. The best example is the recent creation of a public 'fund of funds' (FOND-ICO Global) with a budget of up to €1.2 billion to contribute to venture capital funds whose investment targets are Spanish companies. The aim of this public fund of funds is boosting domestic investment in Spanish start-ups, venture capital and incubation-related investments with no or limited access to the credit market.

Regulators, target boards and shareholders in general also perceive private equity more as an opportunity than a threat (by way of example, the regulator approved the sale of EVO Bank to Apollo). Shareholder activism remains very rare in Spain and limited to 'say-on-pay' and disputes for control among strategic shareholders. The fact that many Spanish-listed companies have controlling shareholders creates obvious obstacles to activists.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

CH & DLG: Since the summer of 2013 we have experienced an explosion of divestments, with volume increasing by 20 per cent. The first half of 2014 showed the continuation of the trend, with

Diana Linage Gómez

"Private equity in Spain is viewed positively by the public in general and is increasingly seen as a catalyst for economic growth."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

First, the special regulatory framework of Spanish private equity entities, which will soon be completely overhauled following the transposition of the AIFMD Directive. Second, the particular tax rules applicable to private equity sponsors and their investments. Third, the coexistence of both domestic and foreign players, each with specific investment philosophies, corporate values, internal restrictions and return commitments with investors.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

1. A comprehensive understanding of the local market and the client's business, and a practical approach to business issues in order to provide creative legal solutions, should be the first consideration.

2. Experience and track record on private equity transactions and within the specific target sector, with a truly full-service approach, are also essential to complete a successful transaction.

3. Finally, transaction management skills, together with the existence of a top-quality international network able to provide seamless advice across different jurisdictions are of increasing importance.

What is the most interesting or unusual matter you have recently worked on, and why?

We recently advised Eurazeo on its minority investment in Desigual, a Spanish company engaged in the fashion clothing business. Besides being a very interesting and 'creative' deal requiring the implementation of special protections and exit rights for the private equity sponsor in a minority investment, the parties involved (the individual founder of the business as majority shareholder), the positive working environment and the activity of the target made this a fun transaction to work on.

Christian Hoedl & Diana Linage Gómez
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examples of significant divestments that followed dual and even triple-track processes. The most frequent exit routes are private sales to third parties, IPOs and secondary sales to other private equity funds.

Notable divestments include Carlyle's exit from Applus+ and the sale of ONO to Vodafone (as previously mentioned) but also a myriad of smaller divestments by private equities that had to be postponed in the financial crisis.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

CH & DLG: Although some traditional investors (eg, savings banks) have disappeared from fundraising and other domestic investors have reduced their exposure to the asset-class in recent years, fundraising clearly improved in the first half of 2014. Indeed, preliminary data suggests that fundraising increased by 315 per cent in the first half of 2014. While still a majority of new funds raised were contributed by domestic investors, foreign investors and funds of funds are also again considering Spanish PE sponsors.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

CH & DLG: Private equity entities in Spain may be created either as private equity companies or as private equity funds. The private equity entity (regardless of whether it is incorporated as a company or as a fund) must pre-define its investment policy, setting forth, among other things, target investment sectors and geographical areas, target eligibility criteria, maximum and minimum investment timelines, exit routes and type of financing that may be granted to portfolio companies. Additionally, some legal limitations apply on the composition of the entity's assets. As an example, as from the third year since its incorporation, 60 per cent of the entity's assets must consist of shares (or financial instruments that may vest a right to acquire the shares) of portfolio companies within the entity's corporate purpose. Of that 60 per cent, profit participating loans may not exceed 30 per cent and stakes in other private equity entities may not exceed 20 per cent.

Private equity entities must be authorised by, and registered with, the Spanish Securities and Exchange Commission (CNMV). A report explaining the project to be pursued, the initial contributors, the investment policy (as previously mentioned), the distribution policy, and the financial project of the entity must be filed with the CNMV together with a prospectus including the company's articles of association or the fund's internal regulation and the main financial and legal aspects of the entity. Additionally, unlike the creation of private equity funds, the incorporation of private equity companies must be formalised in a deed granted before a notary public and must be registered with the Commercial Registry.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

CH & DLG: Spanish private equity sponsors are closely supervised by the CNMV. Some matters such as the modification of the constitutional project, the articles of association or the internal regulation of the funds must be authorised by the regulator. Furthermore, private equity entities must comply with several reporting obligations, in particular those regarding financial and auditing information. However, those obligations and the CNMV's supervision do not have a major impact on the day-to-day business of Spanish private equity entities, as reporting obligations are manageable and the circumstances that may require authorisation by the CNMV are quite limited.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

CH & DLG: The AIFMD has yet to be implemented in Spain. The major changes sought by the new regulation will affect the managing companies of Spanish private equity entities. The new legislation is expected to set out much more detailed regulations on the functions and limitations of managing companies. Additional obligations are also anticipated in connection with equity requirements depending on the amount of the portfolios under management. Other obligations anticipated include the need to approve and implement policies on remuneration and incentives, conflicts of interest, risk management and a maximum leverage level.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

CH & DLG: As discussed previously, leveraged investments (not only by private equity sponsors, but by any investors) are struggling in response to recently enacted tax legislation that has limited the deductibility of financing expenses to a maximum of 30 per cent of operating profit of a given tax year and has eliminated the deductibility of interest deriving from intra-group indebtedness granted to finance the acquisition of shares by another group company (unless the taxpayer evidences that there are valid business reasons for the transaction). Furthermore, the structure traditionally used for the debt pushdown has been impaired by recent tax rulings and court decisions that have denied the existence of valid business reasons for the application of the special neutrality tax regime to the merger of the target company and the investment vehicle.

Other temporary measures reducing both the amount of carry-forward losses that can be used to offset positive tax bases and the tax-deductible amount of the merger goodwill have also worsened the Spanish tax framework on buyouts.

The Spanish government has announced an additional tax reform to be enforced as of 1 January 2015. The main changes foreseen in corporate income tax affecting the taxation of private equity include the reduction of the general tax rate to 28 per cent in 2015 and to 25 per cent as from 2016, the non-deductibility of interest on profit participating loans (PPLs), additional limits on the deductibility of interest derived from acquisition finance, new rules for the avoidance of double taxation on dividends or capital gains from foreign and domestic subsidiaries, and new limits on offsetting tax losses carried forward.

Carried interest is not governed by any specific regulation in Spanish tax legislation. Although private equity partners tend to treat carried interest as capital revenue linked to preference shares issued by the private equity fund, some non-binding tax rulings suggest that carried interest should be treated as employment revenue.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

CH & DLG: Private equity in Spain continues to face a number of challenges in 2014, mainly related to the weakness of the Spanish economy and new tax regulations. The implementation of the AIFMD will create additional burdens for general partners. Private equity sponsors will face increasing competition from strategic investors, and investors from Latin America and Asia.

Nevertheless, deal volumes and values are expected to continue to rise in the second half of 2014 and in 2015. Deal-flow should continue to improve. The deleveraging process by banks and corporations will continue and lead to divestments from non-core and/or non-performing assets and loan portfolios. Family-owned businesses facing succession issues continue to be a good opportunity for PE investments. Private equity firms are expected to complete overdue divestments from portfolio companies through trade sales and secondaries.

The improvement in the availability of bank financing and the deployment of alternative financing sources (eg, high-yield bonds, corporate debt, mezzanine financing) should foster investment, particularly by international investors. Improving stock market conditions should also facilitate exits through IPOs.

In terms of fundraising, the recently launched public fund of funds (FOND-ICO Global) is expected to mobilise a significant amount of resources for investments in Spanish venture capital and incubation projects.


Jon Ericson

PRIVATE EQUITY IN SWEDEN

Jon Ericson is the managing partner at Ashurst's Stockholm office, where he specialises in public and private M&A, private equity and ECM. The firm's Stockholm practice has a focus on M&A and private equity, leveraged and acquisition finance, DCM, ECM and regulatory work. Key clients include Swedish and international sponsors, financial institutions and corporates.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Jon Ericson: The landscape has certainly been changing for quite some time. Over the last 12 months we have seen lower investment activity due to fewer secondary deals, as sponsors currently tend to exit through the stock market, but still a fair amount of activity in the mid-cap segment, while the volumes of large cap deals are down.

We are also seeing less frequent use of traditional auctions and more bilateral situations and pre-emptive bids.

Moreover, the current climate is conducive to an increasing number of recap transactions.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

JE: Straight buyouts are bread and butter work for most sponsors in Sweden. While we certainly

Image: maisicon /iStock/Thinkstock

come across a lot of flexibility as to co-investment structures, control or at least co-control over the assets is key for many. At the same time, there are sponsors who retain the flexibility to invest in minority stakes if the right opportunity occurs.

Loan-to-own and investments in restructuring situations are increasingly frequent deal types.

Online retail and financial services are sectors that are likely to see a fair amount of activity. Infrastructure is another sector to watch.

There is always a more or less significant amount of add-on activity.

GTDT: What were the recent keynote deals? And what made them stand out?

JE: EQT's IPO exit of Sanitec in late 2013 is noteworthy since at that time it was the largest IPO in Sweden – in several years – and probably had a significant psychological effect for others to follow. The recent IPO of ComHem is also noteworthy. After a tertiary buyout in 2011, ComHem was floated in June in the largest IPO to date this year. I would also mention Altor's recent €2 billion fundraising, since the fund is the first major Swedish onshore fund, structured as a Swedish limited liability company.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

JE: Yes. There is rarely such a thing as a domestic deal. Even in a deal involving Swedish parties only, sizeable targets tend to have operations in multiple jurisdictions. The key is as always to ensure quality, consistency and speed in all jurisdictions involved.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

JE: Bank lending remains the primary source for financing private equity deals in Sweden and the Nordic region. Swedish banks are well-capitalised and have continued to support private equity acquisitions throughout the credit crisis and the drastic changes in the Continental European banking market have not been repeated in Sweden. Consequently, Swedish and Nordic banks continue to be the main players in the acquisition finance space and private debt providers, such as credit funds, have not entered the local market to the extent seen in other European countries. New financing products, such as unitranche loans and first and second lien structures, have only been seen in a very limited number of deals.

One growing trend, however, is the use of the local high-yield bond market to finance private equity acquisitions. High-yield notes issuance has increased substantially over the last 12 to 18 months and is likely to continue to be an attractive option to finance acquisitions given the low interest rate environment in Sweden. The local high-yield market utilises a very slim document package compared with US and European high-yield issuances. Large cap deals are mainly financed by tapping US and European capital markets and Swedish-based sponsors are increasingly taking advantage of the liquidity in those markets.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

JE: Prior to the implementation of the AIFMD sponsors were not subject to any specific legal or policy regimes focusing on the private equity industry in Sweden. This implementation is a significant development on the regulatory side. The Swedish legislature and the tax authorities have also been looking at various techniques for challenging certain aspects, for example, group funding structures and the taxation of carried interests under existing regimes, as well as discussing new frameworks for addressing certain perceived weaknesses in the existing tax regimes.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

JE: The private equity industry in general gets a lot of recognition for its significance as a driver of industrial and economic development. However, as to certain publicly funded sectors, there has been some debate, on a political level, regarding private equity ownership of health-care and education providers. There is a political uncertainty involved in investments in these sectors.

Shareholder activism plays a limited role in the Swedish market.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently and why?

JE: Exit activity is currently fairly high and is likely to be sustained for some time. Clearly there is a shift towards the IPO route at the moment. At the same time a sale track is often tested in one way or another to validate the pricing in the IPO, and we increasingly see examples of bilateral deals and pre-emptive bids alongside traditional exit processes.

Again, the recent IPO of ComHem is a noteworthy example. After a tertiary buyout in 2011, ComHem was floated in June in the largest IPO to date this year.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

JE: The market moved in favour of investors during the financial crisis and as a result of initiatives such as the ILPA guidelines. Since then, generally, there has been a gradual movement back in favour of sponsors. However there has been a flight to quality with the result that there is a very significant difference between the position of sponsors with the strongest track records, who are in great demand and who are therefore able to raise funds on strong terms, and that of other sponsors.

Generally speaking, the fundraising levels in Sweden have not changed to any significant extent in the past five years. The statistics are, however, not very telling, since there is a limited number of fundraisings each year and a significant spread in size. The most recent fundraising we advised on in Sweden totalled €2 billion.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

JE: Typically a major fundraising will take between four months and a year, but can sometimes take even longer. That is primarily determined by commercial considerations and investor processes rather than legal or technical restrictions. A typical process might start with pre-marketing during which a sponsor will discuss outline concepts with interest investors. Then marketing materials will be prepared, in particular a fund PPM, and due diligence materials will be collected, in particular on the sponsor's track record. Drafting of legal documentation will follow, such as a limited partnership agreement or debenture holders' agreement, an investment management/advisory agreement, investor application forms, and legal opinions. The fund terms will thereafter be negotiated with investors, including the preparation of side-letters. Closing of the fund will involve the acceptance of application forms, issue of side-letters and legal opinions.

The most significant recent development in Swedish fundraisings is the onshore funds. Historically international funds were raised typically using offshore limited partnership structures. More recently onshore funds have been established using Swedish limited companies (ABs) which have issued participating debentures to investors. Such structures can be used to replicate the commercial terms of international funds that more commonly are implemented using limited partnerships.

Jon Ericson

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

JE: Sponsors regulated under the AIFMD regime are supervised by the the Swedish Financial Supervisory Authority. The introduction of the AIFMD regime naturally creates a step that requires some initial attention and time such as identifying suitable techniques for the custodian's safe-keeping of assets other than those typically encountered by UCITS custodians. The involvement of a regulator in the process creates additional layers of work streams and functions but once established, it is not expected that the SFSA's supervision will have a major impact on the day-to-day business. To what extent the asset-stripping provisions in the AIFMD will impact funding structures in the future is yet to be seen.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

JE: For onshore EU fund managers Sweden should be in much the same position as any other EU jurisdiction. For offshore or non-EU fund managers I do not think Sweden is seen as one of the difficult jurisdictions to market fund interests by way of private placement. The main issue is timing. While the process is not as complicated as in some jurisdictions it is still an administrative burden with timing issues being the main result. These problems are currently being magnified by the lack of real guidance from the regulator.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

JE: The two major tax issues facing private equity in Sweden relate to carried interest and the tax deductibility of interest on shareholder loans.

The Swedish tax authority has in the past few years challenged the tax treatment of carried interest for a number of Swedish sponsors arguing that carried interest should be taxed as salaried income and be subject to social security charges. The first case went against the tax authority in court, but is subject to potential appeal, and the outcome was a matter of evidence rather than of principle, which means that it remains to be seen whether and to what extent the challenges will be successful.

"There has been some debate, on a political level, regarding private equity ownership of health-care and education providers."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Sweden is highly a competitive market on which both local and international sponsors are active. Relative to the size of the market, private equity activity in Sweden is disproportionally significant. This is illustrated by the fact that close to 8 per cent of all the employed workforce, which is not employed in the public sector, is employed by private equity owned companies. Furthermore, the Swedish market has shown a remarkable resilience during the financial crises.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

1. First of all, the client should look for a firm that fundamentally understands the characteristics of private equity. Understanding the investment-related work as such is not enough; the fund and advisory set-up, the financing methods, and of course the endgame are also key.

2 Second, the client should look for a firm with not only Swedish but also international financing capabilities. In particular in major buyouts the financing or certain parts thereof would often be governed by, for example, English law, and the choice of law could change during the course of the process.

3. Third, to ensure that the firm of choice has the capacity and experience to manage complex deals, and to cover the two points already mentioned, clients often chose to work with an international firm with presence in Sweden, or with an international firm supported by local counsel.

What is the most interesting or unusual matter you have recently worked on, and why?

We recently acted for Agilitas Partners, a pan-European mid-market private equity firm, on its maiden investment with the buyout of ISS Damage Control from ISS Group. ISS Damage Control operates in the Nordics and the transaction was a complicated carveout from the ISS Group. Ashurst was lead counsel for Agilitas, coordinating and carrying out due diligence across the relevant jurisdictions, negotiating the sale and purchase agreements and dealt with management investment in the new holding group. In addition, Ashurst was lead counsel on the financing of the transaction with senior debt provided by a major Nordic bank.

In parallel with the investment, Ashurst was legal counsel to Agilitas in the formation and first close of the maiden Agilitas fund.

The combination of the execution and financing of the maiden deal, and the raising of the maiden fund in parallel, makes the deal unique and truly demonstrates the depth and breadth of our practice.

Jon Ericson
Ashurst
Stockholm
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As to deductibility of interest on shareholder loans, new rules were introduced in 2013. These rules limit the scope for such tax deductibility and therefore make it more difficult to optimise the tax structuring of deals.

A government committee also recently presented a report for a new corporate tax system which would significantly further reduce the possibility to deduct interest expense. At the same time the report proposes a reduction of the corporate tax rate. These proposals are in an early phase and the outcome remains to be seen.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

JE: We can expect variations on the familiar themes. The supply of both equity and debt is there. The big question at the moment is how long the IPO window will be open. How long will the stock market continue to value assets at competitive levels, and how long will the level of demand be sustained?

Christoph Neeracher

PRIVATE EQUITY IN SWITZERLAND

Christoph Neeracher specialises in international and domestic M&A transactions (focusing on private M&A and private equity transactions, including secondary buyouts and distressed equity), transaction finance, corporate restructurings, corporate law, general contract matters and all directly related areas such as employment matters for key employees.

He is experienced in a broad range of national and international transactions both sell- and buy-side (including corporate auction processes) and the assistance of clients in their ongoing corporate and commercial activities. Additionally, Christoph represents clients in litigation proceedings relating to his specialisation.

His private equity clients include Capvis, G Square Capital, Partners Group, SK Capital Partners, etc.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Christoph Neeracher: In the past year, the Swiss M&A market has once again been fertile ground for private equity players, who were involved in an array of transactions. Although still mainly active on the buy-side, the continued Swiss stock market rally has also resulted in elevated transaction multiples for trade sales – thereby fuelling both private equity-backed sales to strategic buyers as well as sponsor-to-sponsor deals.

After a subdued 2013 in the Swiss M&A environment, the first half of 2014 was characterised by a comeback of mega deals, most notably the approximately 41 billion Swiss francs blockbuster merger between Lafarge and Holcim. On the backdrop of an increase in billion-dollar deals, private equity related deals have also gained traction. According to a market survey by Ernst & Young, M&A deals with private equity involvement in the Germany, Switzerland and Austria region showed a marked increase in both Q1 and Q2 of 2014, with a year-over-year increase of 71 per cent and 64 per cent respectively against last year.

While small and mid-market targets remained the sweet spot for sponsors on the buy-side, there were also some big ticket private equity-backed exits recorded in the Swiss market, most notably the approximately 1.55 billion Swiss francs exit of Nuance Group by sponsor PAI to strategic player Dufry.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

CN: Private equity firms active in Switzerland follow a wide range of strategies, including control and non-control deals, club deals and joint ventures with corporates.

A notable example of a Swiss club deal was the joint-acquisition of VAT Holding AG by both Capvis, a Swiss mid-market private equity player, and Partners Group, a global private markets firm headquartered in Switzerland, showing that the players will also consider more creative, collaborative approaches to tackle targets outside their transaction sweetspot when the underlying economics of the investment opportunities appear favourable. Typically, private equity players taking non-control positions seek protection via shareholders' agreements, which usually not only restrict the transferability of the shares, but also include board appointment rights as well as provisions regarding voting undertakings for certain or even all board and/or shareholders' resolutions. In this respect, Swiss law provides ample flexibility and Swiss market practice has in recent years reached a high level of sophistication.

As Switzerland's economy is well diversified, private equity firms traditionally are active in a wide array of industries. Recent 'hotspots' included the life sciences, communications, consumer services, computer and consumer electronics sectors as well as the energy and environment sectors.

With respect to the investment stage, recent private equity deal flow in Switzerland is concentrated around lower risk growth and LBO investment opportunities, with less activity in the VC and distressed/turnaround space.

GTDT: What were the recent keynote deals? And what made them stand out?

CN: Recent private equity keynote deals included the acquisition of a 49 per cent minority stake in Ringier's new media Scout24 Schweiz and Omnimedia by the US private equity giant Kohlberg Kravis Roberts. While the transaction is still subject to approval by the competent merger control authorities, the deal marked the first direct investment by the US private equity fund in Switzerland, demonstrating again the attractiveness of the Swiss market for seasoned investors.

In terms of legal complexity, the most remarkable deal in the last twelve months was SK Capital Partners' acquisition of three business units from Clariant. The deal required close coordination of legal advisers over a period of around nine months and across 35 jurisdictions, as a new stand-alone business, now operating under the name

Archroma, was created through numerous share deals and asset carveouts.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

CN: Despite healthy domestic private equity M&A deal flow, cross-border deals, especially between Switzerland and Europe, are traditionally a major source of Swiss M&A activity. Such activity is bolstered by the fact that there are generally no foreign exchange control or similar laws which would restrict investments or acquisitions in Switzerland by non-Swiss persons or companies (although there are some sectoral restrictions in the insurance, banking, securities trading and TMT sectors, as well as for real estate transactions).

As some European bidders are still struggling with the challenging economic environment in the eurozone and given the fact the Swiss franc is still strong, Swiss targets are still expensive. On the other hand, Swiss bidders have been cautious to go after European targets in the wake of the European crisis.

Recent months showed that on the backdrop of the economic recovery in the US and rising manufacturing costs in China, Swiss bidders have increasingly turned to US targets. This trend has been mirrored in inbound activity, which has seen a rise of US bidders for Swiss targets.

Cross-border transactions with Swiss involvement also create challenges for legal advisers involved in these transactions, as coordination and communication become the key success factor. Thus, getting all legal advisers on the same page, by assigning clear responsibilities and committing to strict deadlines from kick-off to closing, is critical, in particular where coordination has to take place between different law firms that are dispersed over different time zones. Although not always without frictions, the major Swiss corporate law firms are well experienced in handling multi-jurisdictional M&A transactions and dealing with fast-paced private equity dealmaking.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

CN: On the backdrop of record low interest rates, an expansionary monetary policy by the Swiss National Bank and banks continuing to become more flexible, financing conditions remain favourable for funding Swiss buyouts. While not at 2007 level, debt-to-EBITDA levels have been on the rise, in some instance even hitting six times EBITDA.

Although Swiss tax law stipulates certain de facto limitations regarding company's debt-to-equity ratio, Swiss corporate law generally does not provide specific rules on a company's debt-to-equity ratio and buyers are therefore very flexible with regard to transaction financing.

Securing bank financing can be challenging, as banks are still cautious and require respective guarantees when lending funds to borrowers. Banks and other financing institutions usually protect their rights by taking pledges over both the shares in the portfolio company as well as any material subsidiary of such company. Furthermore, it is market practice for financing banks to require that the existing debt will be refinanced and the existing security will be released and used as collateral to secure the financing.

Up- and cross-stream guarantees as well as other security interests granted by the target to the parent or an affiliate (other than a subsidiary) are subject to various restrictions. According to Swiss corporate law, the grant of security interests must be covered by the company's purpose according to its articles of association. In addition, the approval of both the shareholders' meeting as well as the board of directors is required. On top of such corporate law requirements, special attention should be paid to certain limitations arising from tax law.

Finally, financial planning is one of the board of directors' duties which cannot be delegated. Hence, if excessive debt burdens lead to bankruptcy, such bankruptcy may ultimately lead to personal liability of the members of the board of directors.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

CN: In March 2013, the Swiss voters approved a new law against 'fat-cat' salaries. The law is, however, only applicable to companies listed in Switzerland. It calls for extensive new mandatory rules on transparency and compensation of board members and senior management. The new law, among other things, prohibits severance payments, advance payments and similar extraordinary payments to directors or senior managers. As of the annual general meeting 2015, shareholders' approval regarding the aggregate compensation of the board of directors and the senior management will be mandatory. Additionally, the articles of association will have to include rules for directors and senior managers on loans, retirement benefits, incentive and participation plans, and the number of mandates outside the group. Furthermore, the institutional voting representation by governing bodies of the company itself or custodians is henceforth abolished, which will strengthen the role of the independent proxy.

As a consequence of this new law, some smaller listed companies may consider a delisting in order to avoid the new regulations and related legal and compliance costs. Accordingly, private equity players may step in to enable a taking private of listed companies. As witness in the course of last year: in a historic first, a public Swiss company (Acino Holding) was taken private by two private equity players (Avista Capital Partners and Nordic Capital). Whether this deal heralds the beginning of a new wave of such transactions remains to be seen; the transaction demonstrated, however, that delisting can be a real option in Switzerland as well.

Another important change in the legal landscape was the introduction of the second amendment to the Collective Investment Schemes Acts, which aims at further adapting the Swiss regulation to international standards, such as AIFMD. The amendment requires Swiss asset managers to hold a licence from the Swiss Financial Market Supervisory Authority (FINMA) in order to manage foreign collective investment schemes and as a consequence, fundraising has become more complex.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

CN: While there were some negative headlines in the newspapers in the past, the German 'locust' rhetoric never caught on in Switzerland and the Swiss public is generally not too concerned about industrial firms falling into the hands of private equity. As a consequence, there is no regulatory framework specifically targeted at such firms.

Resistance to buyouts by target boards can be an issue where the transferability of shares is restricted (which is common). Such transfer may be denied by the board of directors upon the existence of 'important reasons', as usually defined in the articles of association. If the target is a listed company, the board of directors may refuse to enter the shareholder into the share register only if a shareholder exceeds a percentage of the company's voting rights (as defined in the articles of association) or if the purchaser does not state that the shares are held in its own name and on its own account.

In recent years, shareholder activism has risen significantly. As this is a phenomenon that primarily affects listed companies, there is no direct connection between shareholder activism and private equity transactions.

It is, however, possible that the new law against 'fat-cat' salaries, which strengthens shareholders' rights, could lead to increased shareholder activism in listed companies.

Christoph Neeracher

"While there were some negative headlines in the newspapers in the past, the German 'locust' rhetoric never caught on in Switzerland and the Swiss public is generally not too concerned about industrial firms falling into the hands of private equity."

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

Switzerland's stable political system, liberal economy, highly educated workforce, sophisticated and efficient legal environment, and traditionally mild tax regime all contribute to an excellent environment not only to private equity, but also to business environment in general.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

The most important thing is without a doubt deal experience, followed by industry knowledge and availability.

What is the most interesting or unusual matter you have recently worked on, and why?

Every deal raises interesting and unique questions. One of the most interesting and challenging deals we worked on in the last few months was definitely SK Capital Partners' acquisition of Clariant's business units textile chemicals, paper chemicals and emulsions. As the transaction consisted of share and asset carveouts in over 35 jurisdictions around the globe, we liaised with dozens of colleagues from other law firms all over the world. It was fantastic to see how this transaction turned out to be a success for both parties.

Christoph Neeracher
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GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

CN: According to the European Private Equity & Venture Capital Association (EPVC), the number of exits in Swiss targets remained on the same rather low level as in previous years. With regard to exit routes, divestment by trade sale is still the main exit method. There were, however, also divestments by way of sale to other private equity houses or even to the management. Exits by way of a going public on the SIX Swiss Exchange are still less common, despite the Swiss IPO window reopening in the second half of 2013. According to EPVC's data, between 2007 and 2013 only three Swiss private equity held companies were divested by way of an IPO. One reason for this low exit activity lies in the fact that the SIX Swiss Exchange's listing rules set the bar for an IPO quite high. According to those rules, there must be a free float of at least 25 per cent following the listing, which means that at least 25 per cent of all of the issuer's outstanding shares have to be in public ownership. Furthermore, the capitalisation of those shares in public ownership has to amount to at least 25 million Swiss francs. However, despite these regulatory hurdles, with the strong global IPO traction and Europe and the US hitting record levels for 2014, as the backlog of IPO candidates from the crisis years comes to market, chances are good for a PE-backed exit by IPO in Switzerland in the near future.

Additionally, it has to be kept in mind that the exit strategy very much depends on the provisions of the investment contracts. Should an investor not be the sole shareholder of a target, it is common practice to conclude a shareholders' agreement between all or at least a majority of the targets' shareholders. Such an agreement usually contains numerous limitations regarding the transferability of shares to third parties and therefore often restricts possible exit options.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

CN: On the backdrop of a rising public equity market, allocations to alternative investment funds have increased over the last months as institutional investors have started liquidating some of their stock market gains and shifting them into the less crowded private markets. The positive investor sentiment and portfolio rebalancing has resulted in a series of successful fundraisings by a number of Switzerland's leading private equity players. These included the successful closing of a €720 million fund by Capvis and Partners Group raising €1.5 billion direct investment commitments.

Investment funds are a pool of capital and have no operative activities. As already mentioned, after a major revision of the Swiss collective investment schemes legislation in 2013, private equity funds may qualify as collective investment schemes under Swiss law (Collective Investment Schemes Act, CISA). Under the revised CISA, there is no distinction between public distribution and private placement. As a result, only the concept of 'distribution' is relevant to determine the admissibility of offering interests in private equity funds in or from Switzerland.

As a consequence of the revision of CISA, fundraising has become more complex during the last few years. In particular, special attention has to be paid to the question what kind of investors can be approached for fundraising. In short, interests in private equity funds may still be freely offered to regulated financial intermediaries such as banks, securities dealers, fund management companies and insurance companies in Switzerland (the 'super-qualified investors'). Fundraising from these super-qualified investors does not qualify as 'distribution' and is therefore not subject to the distribution rules of the CISA.

The case is different for the offering of interests in private equity funds to qualified investors as this may be subject to legal and regulatory requirements. Under the revised CISA, private equity funds or the general partner (who acts for the private equity fund), respectively, must appoint a Swiss representative and a paying agent in Switzerland. Furthermore, the sponsors or other entities offering interests in a private equity fund to qualified investors must either obtain a distributor licence from the Swiss regulator FINMA or, in case of foreign sponsors acting on a cross-border basis, be licensed to distribute fund interests in their respective home country.

Furthermore, it must be noted that the definition of 'qualified investors' has significantly changed under the revised CISA. Whereas pension funds generally are deemed to be qualified investors, foundations, family offices and high net worth individuals usually are deemed to be non-qualified investors and are treated as qualified investors only if specific requirements are fulfilled. Therefore, before any fundraising may take place in Switzerland, sponsors and private equity funds should seek for legal advice by securities lawyers.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

CN: In Switzerland, private equity funds typically seek to raise capital in 'private placements' of interests in accordance with exemptions from the approval requirement of the CISA with respect of the fund. Such approval by FINMA is required for the distribution of fund interests to non-qualified investors, whereas no such requirement exists for the fundraising with qualified investors.

Generally speaking, private equity fundraising is effected by one-on-one presentations by general partners (GPs) to investors (LPs), often set up by specialised placement agents. These presentations typically involve the distribution of a private placement memorandum or other marketing documents. Although it is not a requirement under Swiss law, it is advisable to include specific Swiss disclaimer language in all offering/marketing material and legal advice should be sought from securities lawyers before any investor is contacted. Furthermore, as already mentioned, fundraising must take place in accordance with all the applicable legal and regulatory requirements.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

CN: As mentioned, fundraising in Switzerland is nearly always made as 'private placement' of interests in the private equity fund. If sponsors seek to raise funds from professional investors other than 'super-qualified investors', in particular qualified investors, they must either be supervised in Switzerland (only Swiss-domiciled sponsors) or be subject to equivalent supervision in their respective home country. Entities distributing interests in private equity funds on the basis of a FINMA distributor licence are, once they are granted a licence, not subject to prudential supervision. However, they must at all times comply with the requirements for the granting of such licence. Where a sponsor distributes interests based on another FINMA licence (ie, as asset managers of collective investment schemes which are subject to prudential supervision) the sponsor's daily business may be affected.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

CN: As a non-EU jurisdiction, Switzerland is under no obligation to implement the AIFMD. However, the recent legislative developments in the field of Swiss securities law have their source in the legislative developments on an international level, in particular the EU. Thus, the revision of the collective investment schemes legislation was mainly a result of the AIFMD.

In line with the AIFMD, the revised CISA newly regulates any manager of Swiss and foreign funds. Furthermore, the CISA introduced a new regime governing the distribution of funds in Switzerland.

The Swiss legislature is currently working on a new legislation for financial services and products offered to investors in Switzerland, the Federal Financial Services Act (FFSA). It can be expected that the FFSA will also have an impact on fundraising in Switzerland. The earliest possible date for the FFSA to enter into effect is 1 January 2017.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

CN: Major tax issues include limitations on the acceptance of debt push-down, rules regarding indirect partial liquidation and rules in relation to employee participation.

Generally, mergers in Switzerland may be conducted in a tax-neutral way if tax liability remains in Switzerland and the taxable assets are continued. However, based on the so-called tax avoidance doctrine, Swiss tax authorities often deny tax-effective deduction of interest upon merger of the acquisition vehicle with the target which results in a debt push-down. As a consequence of this practice, alternative debt push-down strategies such as cascade purchases and equity/debt swap have been developed to eschew the tax avoidance doctrine while securing (at least partially) tax effective deduction of interest

As a Swiss particularity, the issue of the so-called indirect partial liquidation applies in case of a qualifying disposal of shares held by a private person as private assets to an investor holding the shares as business assets. Such a disposal of shares of at least 20 per cent formerly held by individual Swiss tax resident investors holding the shares as part of their private assets may qualify as indirect partial liquidation (deemed partial liquidation) if certain conditions are met. If an indirect partial liquidation event is triggered part of the sale proceeds is reclassified as taxable investment income in the hands of the individual shareholder. In principle, any distribution out of existing and distributable reserves (ordinary or construed dividends, including merger proceeds) caused by the buyer during the first five years after the disposal is considered harmful if and to the extent the target had non-operating assets at the time of disposal. Although such taxes arise with the sellers, the sellers will ask for a respective indemnity in the SPA in case the purchaser triggers such an indirect partial liquidation event post closing.

The Swiss Tax Law on Employee Participations together with the respective Circular Letter provides a legal basis for the taxation of financial benefits derived from employee participations. It regulates, inter alia, the taxation value of employee shares, the taxation point of employee stock options as well as the treatment of artificial employee participations, which do not provide for an allocation of ownership rights.

Lastly, there is no special taxation rate applicable to carried interest in Switzerland. Depending on the structure and the domicile, taxation of between 8 and 20 per cent of the carried interest is possible.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

CN: As hard as it is to predict the future, the Swiss players are fairly optimistic. While a comparatively strong Swiss franc makes acquisition in Switzerland expensive, the rising real gross domestic product, positive stock market trends, low interest rates and good quarterly results recently published by many major Swiss companies are quite strong indicators of a stable market environment and lay a basis for a busy M&A and private equity market. It is therefore possible that the M&A and private equity market will gain further momentum in the next quarters. The high stock prices could also lead to private equity companies placing assets from their portfolios up for sale on the market.

Last but not least, it will be interesting to see how the revised legislative and regulatory framework will affect the private equity business in Switzerland. It goes without saying that it is important for all the market players to be well prepared for the introduction of the FFSA and all other upcoming laws and regulations.

PRIVATE EQUITY IN THE UNITED KINGDOM

David Carter is co-head of Ashurst's global private equity sector specialising in buyouts and cross-border mergers and acquisitions. David's key clients include Agilitas Private Equity, Oakley Capital and Electra Private Equity.

Recent transactions include advising Nomura International plc on the £1.1 billion recapitalisation of Wood MacKenzie, advising the Shareholders of the Ontex NV on the €1.2 billion sale of the Ontex Group, the College of Law management team on its £200 million sale to Montagu Private Equity, RBS Private Equity on the £500 million Allied London Properties MBO and acting for long-standing client Oakley Capital on Sir Martin Broughton's £230 million bid for the Tote and the acquisition of a controlling stake in Time Out New York.

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

David Carter: We have seen a real upturn in activity levels involving private equity clients in the UK in the last 12 months. There are some trends that support this surge in deal flow:

There is now a substantial amount of dry powder available for commitments to invest in deals within the private equity fund industry and firms are coming under increasing pressure to transact while not losing the discipline of sensible investing. Recent valuations have increased, in part, as a result of this competition to deploy capital.

Initial public offerings have been the exit method of choice for private equity investors in the UK in the last 12 months. Valuations have been markedly above those achievable through private sales, even to strategic or trade buyers where synergies often mean an increased price over and above those offered by private equity investors. Public markets exits have remained buoyant as a result of the strong resilience shown by post-listing share prices in many cases. It is debatable whether a fall in the number of exits via the public markets will

result in an immediate increase in private M&A as there will be a valuation expectation to be managed.

Private equity funds are seeing an upturn in co-investment right requests during fundraising. These are not regularly granted with sponsors preferring to offer an opportunity on a deal-by-deal basis. Cornerstone investors in new funds are sometimes given a co-investment right. The ability of private equity houses to do larger deals relying on co-investment for an equity shortfall means that firms are now able to compete in larger transactions.

Private equity funds are also willing to bridge the funding shortfall by forming consortia. This often has the effect of reducing competition on auction sales.

We have also experienced a high volume of direct investing from entities that have traditionally invested through private equity funds such as pension funds particularly in Canada where for example Omers and AIMCo purchased Vue Cinemas from Doughty Hanson in 2013. Such investors continue to allocate capital to funds in all asset classes but are happy to take direct exposure to specific assets.

Buyout firms are really having to differentiate themselves in order to compete in auction processes and put their money to work. This may be by the combination of a target with an existing portfolio asset or by bringing in local jurisdiction consortium partners for assets in particular jurisdictions.

Some have not been tempted to compete on price, rather going back to basics and investing smaller amounts in a greater number of smaller cap transactions or specialist sectors.

We have seen a move to greater allocation by limited partners to different asset classes: real estate; infrastructure and energy services; and debt. Again, the amount of dry powder in these asset classes is considerable.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

DC: As a result of high public market valuations, competition on auction sales and the prices that trade buyers are able to pay (as a result of increased M&A war chests and potential synergy savings), private equity firms are increasingly looking to extend the market within which they invest (either by teaming up with other private equity firms or by permitting large-scale co-investment on acquisitions). Ashurst's activity level for private equity-owned portfolio companies looking at bolt-on acquisitions and minority stake investments has remained strong in the last 12 months.

Some private equity houses are playing a 'longer game' than traditionally they would have done in order to build a substantial portfolio group via bolt-ons and thereby, hopefully, increasing the ultimate exit value. Quite often these bolt-on acquisitions are funded via shareholder debt and therefore there is a return built into the terms of the shareholder debt which would otherwise not arise were the capital to remain committed but undrawn.

GTDT: What were the recent keynote deals? And what made them stand out?

DC: As noted before the early year surge of IPOs was a significant and welcome return to public market exits by PE houses including the AA and Saga. Ashurst acted for Merlin on its IPO. Prior to the IPO, the team effected a complex group reorganisation to unwind a typical private equity Luxembourg structure into a UK plc with one class of ordinary shares while ensuring that the reorganisation did not trigger significant tax costs to Merlin in multiple jurisdictions all the while avoiding triggering a mandatory bid under the Takeover Code.

I would also note the emergence over the last eighteen months of so-called 'Genesis' deals involving the creation of a fund at the same time as the fund completing its first deal, for example the creation of the Agilitas Fund. The fact that finance could be obtained for a deal in which the investors and main transaction terms were not identified or settled respectively until the point that the debt was finalised shows a return to confidence in all sectors.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

DC: We advise on a real mixture of UK and cross-border private equity M&A – much of what we do has an overseas element. Our global reach means we can service our private equity clients in 15 jurisdictions. We have seen a return to form of private equity transactions throughout Europe. As a result of our organic growth through Europe, our experienced European teams allow us to provide a seamless service to clients. Clients expect to receive the same high-quality commercial advice from all European offices and this will become the main challenge for all legal networks.

There is an increasing willingness among our clients to invest in assets based in what would have historically been considered non-core private equity jurisdictions (Croatia, Slovenia, Poland). In these jurisdictions it is imperative, particularly in auction processes, to ensure that local counsel is appointed early in the process. There tend to be fewer marquee transactions in these jurisdictions and as a result local advisers want to ensure they back the 'winning horse' and, to some extent understandably, work on a non-exclusive basis. Clearly, if the private equity firm requires exclusivity this can be difficult. It is imperative to ensure that you retain the 'A Team' who know the local market, understand the approach to a private equity transaction and can give sensible commercial advice. There is particular scrutiny by private equity investors on transactions involving these sorts of jurisdictions and you need to have lawyers in those jurisdictions who understand the main deal drivers.

A cross-border deal always adds complexity to the acquisition financing. For example, the desire to optimise interest tax deductibility and deliver a robust guarantee and security package to financiers may require acquisition debt to be borrowed across (or pushed into) different jurisdictions, the use of different purchaser vehicles for different jurisdictions or the implementation of post-closing mergers. Recent changes in law (or the reinterpretation of existing laws by tax authorities) have made previously well-known financing structures in continental Europe no longer viable. On the other hand, some withholding tax regimes (such as in Italy) look set to open the door further to international capital. No matter what the mix of jurisdictions involved, the challenges presented by different financial assistance laws, tax consolidation requirements, thin capitalisation rules and security laws continue to remain time-intensive.

Notwithstanding those challenges, there has been sustained credit growth in the last few years which has increased appetite in acquisition finance and eased lending criteria. This has gradually improved the prospects for cross-border financings, notwithstanding the retreat to home markets by some banks. Newer sources of debt capital with less jurisdictional constraints are expanding to fill the gaps, including direct lending credit funds, a resurgence in the European CLO market and the ability to finance purely European deals through the US loan market. As we saw recently with the Ceva Sant Animale acquisition financing, even the more creditor unfriendly jurisdictions (France) can attract significant leverage and cov-lite terms for the right credit. Going further afield, we have acted on a recent underwritten financing with substantial Latin American assets (albeit in a relatively safe sector) and syndicated in Europe – yet another vote of confidence for the prospects of cross-border deals.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

DC: As mentioned, there has been sustained credit growth in the last few years which has increased appetite in acquisition finance and eased lending criteria. The key developments have been:

- a liquid (and resilient) high-yield bond market with yields at historic lows;
- availability of financing through the US loan market (often referred to as a 'US term loan B');
- emergence of cov-lite terms on European deals in 2014 (perhaps delayed by the availability of

US term loan Bs which are typically cov-lite);
- return of a European second lien loan market after a six-year hiatus (partly in replacement of mezzanine);
- emergence of fully portable deals (ie, permitted change of control criteria);
- entrance of credit funds providing direct lending (referred to as unitranche facilities); and
- increasing overall bank liquidity for leverage.

With competition increasing for bank mandates, financing terms have loosened considerably in the past two years (in some cases surpassing the terms available at the top of the market in 2007). The sources of liquidity, however, have changed since then with new entrants and a wide range of new products (such as the direct lending credit funds providing unitranche facilities).

GTDT: How has the legal and policy landscape changed during the last few years in your country?

DC: The tax treatment of private equity over the last few years has been relatively stable and the UK remains, by and large, an attractive jurisdiction for investors and asset managers. While the taxation of members of limited liability partnerships (which is how the majority of asset managers are now constituted) has been subject to some change, a number of consultations have taken place in relation to the taxation of debt and partnerships and individuals can no longer benefit from certain transfer pricing adjustments on related-party debt, but the fundamental principles remain largely unchanged: deductibility of interest costs provided that the debt is on arm's-length terms, low tax leakage on returns for overseas or exempt investors, advantageous rates of tax on capital gains for the management teams of portfolio companies, an attractive carried interest regime and the remittance basis of taxation for non-domiciliaries.

There is, however, the prospect of change – significant change. The OECD has produced, at the request of the G20, an Action Plan on Base Erosion and Profit Shifting. This follows in the wake of the high-profile questions asked of Starbucks, Amazon, Google and other multinationals in respect of their tax profile. From a private equity perspective, the Action Plan, which is intended to address how businesses in the global marketplace are taxed but will necessarily apply to the cross-border movement of nearly all capital, focuses on transfer pricing and the availability of treaty benefits in particular, potentially reducing the amount of debt which can be used in a private equity transaction tax efficiently (because interest deductions will not be available) and limiting treaty benefits, which may create significant tax leakage in fund and underlying holding structures. The Action Plan is currently a plan in process but will start to gain more meaningful shape towards the end of this year. We wait to see its effect on private equity.

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

DC: The UK private equity market is one of the most mature and therefore has had long-standing exposure to the public and policymakers. The role of institutions such as the BVCA cannot be overstated in bridging the gap in terms of understanding between the private equity industry and the public and the industry has made great strides in attempting to increase transparency. That said, we will never be too far from the regular tabloid article heading involving PE fund + portfolio company + cuts or refinancing with PE fund and the leveraged nature of the original acquisition being unfavourably portrayed. The focus on the use of what are perceived to be complex tax and financing structures often obscures the good work investors do in re-energising and turning around businesses (and management teams) that might ultimately fail or allowing growing businesses to reach the next levels of profitability.

"The focus on the use of what are perceived to be complex tax and financing structures often obscures the good work investors do in re-energising and turning around businesses."

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently and why?

DC: The past 12 months have seen a large number of capital market exits for UK private equity-owned groups. Ashurst has acted on some of the largest IPOs in the past 12 months including Foxtons, Riverstone Energy and Esure and expects further capital market exits in the second half of 2014. There has been some element of 'float fatigue' recently but we are inclined to see this as a natural pause for breath before a return to further PE activity.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

DC: The past five to six years certainly saw a market that moved in favour of investors overall. That said, there are still good managers with a track record who have been in the driving seat in their fundraising. Some investor-friendly terms that, pre-credit crunch, were negotiable have now probably become set in stone, such as no-fault divorce. Fundraising is clearly picking up, with investors moving more quickly to commit.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

DC: If a manager is going out with a new concept, then typically the process will start with a teaser document establishing whether there is investor demand. If the manager is creating a successor fund along similar lines to existing funds, then normally the manager would be going straight out with a full private placement memorandum (PPM). A limited partnership structure for private equity still reigns supreme, given its flexibility, tax transparency and familiarity. We have also seen more Luxembourg corporate based structures as well, as some EU institutional investors look for the security of an onshore regulated structure. Timelines to a fundraising really do very much depend on the investor appetite. Broadly, a minimum time to first close from the launch of a teaser or PPM would be six months, and more likely 9 to 12 months. From first close to final close is often now allowed for at 18 months, rather than 12 months, as was standard previously. Key contractual points will be focused on fees, including how transaction fees payable on an underlying deal are shared. Investors will also be focused on key executive clauses (ie, what happens if key executives leave the team) as well as making sure that there are robust allocation provisions, if the manager has competing funds. The most significant legal issue affecting the UK is that of the increased amount of regulation and compliance brought in by the AIFMD, and in this regard we are no different from the rest of Europe.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

DC: Private equity managers operating in the UK have always been subject to regulation by the FCA (formerly FSA, and then before that IMRO). So we do have a developed system of regulation in the UK, which has not always been the case in other jurisdictions. Historically the UK has been, and continues to be, somewhere where the regulation is sensible and focused, with regulators 'getting it' in terms of how the funds work, and the fact that

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The maturity of the market in the UK makes even the most complex and challenging transactions possible with a high level of efficiency. The experience at all levels of the market from financing to corporate advisory means that new market techniques or methodologies are quickly shared from deal to deal so that knowledge of the whole of the market is really key in keeping pace.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

In choosing counsel one has to assume that technical excellence is a given, therefore test:

- Is that excellence founded in one person or is it a strength in depth throughout that counsel's practice? You need strong tax and finance capability as a minimum for PE deals.
- Does your deal require special sector knowledge – if so what experience does your prospective counsel have in that area?
- It is trite, but on the basis that you will potentially be spending a great deal of time with the relevant team, do you like them?

What is the most interesting or unusual matter you have recently worked on, and why?

Too hard a question to answer! I am lucky that all of the deals I do have at least one or two fairly difficult or unusual aspects to struggle through before the deal is finally agreed.

David Carter
Ashurst
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there are highly sophisticated investors in the funds and highly sophisticated managers operating funds. The AIFMD is changing the landscape on this and is having an impact on increasing costs, although broadly everyone accepts the increased regulation. I think the UK is certainly one of the better EU jurisdictions to do business in from a regulatory point of view.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

DC: Fundraising in the UK itself is still largely straightforward for institutional investors. The real problem is that the AIFMD injected uncertainty in terms of fundraising in other jurisdictions, as countries moved slowly to implement regulations. The jurisdictional regimes (absent an EU manager who can utilise the passport provisions) are now uncertain and extremely inefficient. It is odd that a directive aimed at harmonising rules appears to have done the opposite. Clearly where there are sophisticated investors, with a history of investing in funds, it seems odd that regulators are effectively restricting that now for the purpose of 'protection'. Our team here at Ashurst is not convinced that the increased costs, time and complexity has generated any benefits for the institutional private equity fund market. But again, it is something we have to live with and we work with our clients to take them through the hoops.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

DC: As set out above, the most significant tax issue that faces private equity is the Action Plan on Base Erosion and Profit Shifting. Aside from that, it is simply a case of making sure that the benefits of private equity to the UK and beyond are properly understood and the current tax regime is, so far as possible, retained. On carried interest, individuals generally remain subject to tax on their share of carried interest as investment return (eg, as capital gain or dividend/interest income), provided they pay market value for it upfront, and not as employment or trading income, which is typically subject to higher rates of tax and there have been no overt noises that this will change anytime soon.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

DC: The year has started positively and following the re-emergence of the IPO route for exit and a little more realism from vendors as to valuations I expect the levels and volumes of transactions to increase gradually but cautiously throughout the year. There will not, however, be a return to the boom conditions of 2007 any time soon.

However, the outlook is generally better than it has been for some years, with all participants showing confidence in structuring, negotiating and financing deals.

William Curbow

PRIVATE EQUITY IN THE UNITED STATES

William Curbow, Atif Azher, Michael Wolitzer and Jason Herman are partners, and Peter Gilman is an associate, at Simpson Thacher and Bartlett LLP. They have wide-ranging experience in M&A and PE matters, acting for clients including large multinationals, Fortune 500 companies and smaller and closely held private companies, as well as financial advisers, boards of directors and special committees.

Curbow recently represented Vodafone Group in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications. Other clients include L-3 Communications, Crestwood Midstream Partners and Genesee & Wyoming.

Azher's clients have included Hellman & Friedman, Silver Lake Partners, Blackstone, TPG, KKR, Carlyle and Riverwood Capital. Wolitzer has represented sponsors of PE funds such as Apax Partners, Blackstone, Centerbridge, Lexington, JPMorgan/OneEquity, Patria and Silver Lake Partners.

Gilman has represented a number of the world's leading sponsors in a wide range of alternative investment matters, including Alinda, Blackstone, Centerbridge, KKR, Lexington Partners, Oaktree and Silver Lake.

Herman has represented leading domestic and international sponsors in fund formation matters, including Apax, Carlyle, KKR, Blackstone, GSO, Morgan Stanley, AllianceBernstein, Alvarez & Marsal Capital, Evercore Partners, Tiger Management, Lightyear Capital and Square Mile Capital Management.

The private equity team advises on fund formation, minority investments, financing solutions and exit transactions to many of the world's leading private equity sponsors and alternative investment firms, and to smaller first-time funds and independent boutiques, globally covering a wide variety of asset classes, including buyout, real estate, infrastructure/energy and debt funds, as well as customised multi-strategy arrangements and M&A transactions involving alternative investment firms.

Atif Azher

GTDT: What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the last year or so?

Simpson Thacher & Bartlett: M&A activity levels in the first half of 2014 have had the highest percentage gain since 1998 with more than US$1.8 trillion of deals according to Thomson Reuters. Valuations, though, remain at all-time highs, making it increasingly challenging for private equity firms to find attractive targets. In the United States, according to Pitchbook, there were approximately US$244 billion of sponsor investments, which was higher than the first half of 2013, but is less than activity levels for the last six months of 2013, which could suggest a declining trend in private equity acquisition activity.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

STB: Private equity sponsors are increasingly looking for creative ways to deploy their capital. For example, we have seen sponsors seek to provide acquisition financing to large strategic companies in connection with strategic company acquisition strategies. Also, portfolio company add-on activity remains quite active in the United States. According to Pitchbook, the number of 'add-on' investments by private equity sponsors has risen to 61 per cent of all control investments as compared with 40 per cent in 2006.

GTDT: What were the recent keynote deals? And what made them stand out?

STB: Notable deals in the United States include the US$5.4 billion acquisition of Gates Corporation by affiliates of The Blackstone Group, TPG's US$750 million minority investment in Chobani Inc and US$450 million minority investment in Airbnb Inc. Blackstone's acquisition of Gates Corporation is notable because it demonstrates that sponsors are prepared to, and will, deploy large amounts of capital for attractive businesses and that lenders will provide large amounts of credit financing for large LBOs. TPG's transactions are of note because they show that sponsors are increasingly flexible in the way in which they are prepared to invest – depending on the circumstances, larger sponsors are increasingly amenable to taking non-controlling positions of companies that are leaders in their industry or otherwise well-positioned for future success.

GTDT: Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

STB: Significant cross-border private equity is atypical. Many large-cap sponsors have stand-alone region-focused funds, such as Asia-focused funds, that have fund mandates to make investments in particular geographic regions. It is more common for non-US private equity sponsors, such as European funds, to look to the United States for potential investment opportunities. The primary challenges to cross-border investments revolve around financing, tax considerations, and securities laws limitations. None of these are insurmountable, but they increase the level of resources or otherwise complicate the process for execution by sponsors in cross-border investments.

GTDT: What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

STB: The most notable development or trend related to financing in the United States has been the continuation of attractive pricing and availability of credit. In the United States, EBITDA multiples for investments have reached all-time highs. According to Pitchbook, the median EBITDA multiple for private equity investments for the first half of 2014 was 11.5x, as compared to 8.2x in 2012 and 10.4x in 2013. In addition, private equity sponsors are financing their acquisitions with a higher percentage of debt relative to equity – the median debt percentage was 71.6 per cent in the first half of 2014 as compared with 60 per cent in 2012 and 65.6 per cent in 2013. This is allowing private equity sponsors to make certain investments that they would otherwise be unable to justify based on their desired investment returns.

GTDT: How has the legal and policy landscape changed during the last few years in your country?

STB: As a result of the passage of the Dodd-Frank Act in 2010, most private equity firms have been required to register with the SEC as investment advisers. This regulatory shift has resulted in more extensive compliance obligations for the industry as a whole and increased scrutiny by the SEC. In 2012, the SEC publicly began its 'presence exam' initiative to examine a significant percentage of private equity firms, with the goal of, among other things, promoting compliance with certain areas of the Investment Advisers Act that the SEC deems of particular importance. To that end, certain practices in the private equity industry have received significant attention by the SEC, including (i) allocation of fees and expenses to funds and portfolio companies without proper disclosure (eg, operating partner expenses), (ii) shifting of 'firm' expenses to funds or portfolio companies, (iii) marketing/performance presentations, (iv) receipt of transaction-based compensation by PE firms from their fund portfolio companies and (v) allocation of investment opportunities by a PE sponsor among investment vehicles and funds that it manages and other co-investment arrangements.

It is also worth noting that the adoption of rules by the SEC in 2013 in connection with implementation of the JOBS Act has the potential to alter how PE firms communicate with investors and market their private equity funds. More specifically, the SEC adopted amendments to Rule 506 of Regulation D under the Securities Act of 1933 (as amended, the Securities Act) that permit the use of general solicitation and general advertising under new Rule 506(c) so long as the issuer takes reasonable steps to verify that all purchasers of the securities are accredited investors. The additional conditions imposed by the SEC to rely on Rule 506(c) to conduct a general solicitation may, however, decrease the likelihood that private equity firms will seek to rely on the new rules as a practical matter.

Michael Wolitzer

Peter Gilman

"Sponsor exit activity remains strong in 2014 as many sponsors are seeking to harvest their investments during a high-valuation period."

GTDT: What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country?

STB: Fortunately, negative attitudes concerning private equity buyouts seems to have waned in the last year or so. The large number of public company mega-mergers in the first half of 2014 and the public debate relating to so-called 'inversion' transactions seems to have taken the spotlight off of private equity in the near-term.

Shareholder activism associated with M&A transactions has become increasingly prominent in the past several years – irrespective of whether there is any private equity involvement. As a result, private equity sponsors seeking to effect 'going-private' transactions are becoming increasingly mindful of the investor relations aspects of such transactions and are evaluating the risks of potential shareholder activism as part of the 'mix' in connection with effecting such transactions.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

STB: Sponsor exit activity remains strong in 2014 as many sponsors are seeking to harvest their investments during a high-valuation period. Exit levels are coming down from the fourth quarter of 2013, when sponsors made 235 exits for approximately US$62.4 billion in the United States. According to Pitchbook, sponsors consummated 181 exits for approximately US$58 billion and 173 exits for approximately US$44 billion in the first and second quarters of 2014, respectively. Secondary buyouts also remain a common form of exit. A recent study published by Pitchbook shows that in the first quarter, 45.4 per cent of private equity firms sold investments to other private equity firms. In 2009, secondary exits accounted for just 25.4 per cent of all exits. The number of IPO exits by sponsors has increased in 2014 due to favourable capital markets conditions, which may have contributed to the overall declines.

One of the more notable exits is the sale of Biomet Inc to Zimmer Holdings Inc for approximately US$13.35 billion by affiliates of The Blackstone Group, Goldman Sachs Capital Partners, Kohlberg Kravis Roberts & Co and TPG, which is noteworthy due to the sheer size of the exit. In addition, the selling sponsors of Biomet Inc agreed to be paid a portion of their transaction consideration in the form of stock. We have seen several sponsors take a similar approach in 2014

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The United States has blazed a trail in private equity practice over the decades. For example, the United States markets developed both private and public leveraged buyouts (LBOs) in which a significant amount of the purchase price is paid with the proceeds of new debt. As funds are constantly innovating and adapting to changing market conditions, groundbreaking private equity transactions require sophisticated guidance and creative solutions from legal advisers.

Overall, the United States continues to rank as the top market for private equity, reflecting the depth (in terms of size and liquidity) of its capital market and an ingrained culture of innovation. The United States is home to many of the world's most successful and well-established private equity firms, which have traditionally raised the largest buyout 'mega' funds. Historically, United States-focused fundraising has surpassed that of all other regions for private equity investment. As the traditional base of private equity, the United States has attracted the lion's share of capital over the years, and 2013 was no different. In 2013, we saw private equity funds focusing on the United States and North America raise US$288 billion, representing over 63 per cent of aggregate private equity capital raised globally and substantially in excess of the next closest region (Europe at US$105 billion). Through the years, the private equity industry has matured and the experience of fund managers have broadened such that investors continue to view the United States as an attractive jurisdiction for their investment.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

The main consideration in selecting a legal adviser is depth of experience in the private equity sector. Practical experience combined with industry acumen are critical to advising complex transactions dealing with fund formation, minority investments, mergers and acquisitions, financing solutions and exit transactions.

In addition, counsel should have insight into the needs of every participant in private equity transactions, such as private equity sponsors, senior bank lenders, subordinated and bridge lenders, tax advisers, management and financial investors and underwriters. As such, a client would benefit from counsel that offers cross-practice excellence (eg, finance and banking practice areas that provide advice to private equity clients on financing solutions at all levels of the capital structure).

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by selling their portfolio companies to large public companies for a combination of cash and stock.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the last few years?

STB: Private equity fundraising during the first half of 2014 has been strong and reflects a continuation of the trend witnessed last year where larger established sponsors with proven track records are having considerable success raising large private equity funds on favourable terms, while first-time funds and sponsors without proven track records are finding it challenging to compete in today's environment.

The growth in private equity fundraising over the last few years has been substantial as private equity rebounded following the global financial crisis, from roughly US$296 billion in 2010 to US$454 billion in 2013. The second quarter of 2014 saw an increase in aggregate capital raised by private equity funds to approximately US$132 billion (up from US$104 billion in the first quarter), and puts 2014 on pace to be the strongest year for private equity fundraising since the global financial crisis.

With institutional limited partners placing increased emphasis on consistent track records and stability and tending to make larger commitments to fewer private equity funds, established top-quartile sponsors have been able to raise larger funds in shorter periods of time and capture a greater share of the overall private equity fundraising market. By way of illustration, large and mega buyout funds accounted for approximately 77 per cent of buyout fund capital raised in 2013 (up from roughly 50 per cent in 2012), while first time funds represented only 7 per cent of capital raised in private equity (a decline over previous years).

Contributing to the strength of the private equity fundraising market have been a significant increase in private equity backed exits generating record amounts of distributions to limited partners during the past year and solid performance in the public markets. This has led to an overall increase in private equity allocations for many private equity investors and public pension funds as they seek to redeploy distributions into new private equity funds and/or as the size of their private equity basket increases as a result of gains in the public markets and an increase in overall portfolio value (ie, a reverse 'denominator effect'), which should translate into continued growth in private equity fundraising for the remainder of the year.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your country?

STB: While fundraising in today's environment has become less episodic and more resource-intensive, with fund structures, terms and marketing timelines customised to most effectively address the business objectives of the sponsor, we shall outline a simplified framework and timeline for a typical private equity fundraising.

In most cases, the typical fundraising will begin with the preparation and distribution of a private placement memorandum to investors, which includes important information about the sponsor and the fund, including a term sheet setting forth the key terms of the fund and the offering of interests, along with additional disclosure information pertaining to the fund. Many private equity funds are structured as Delaware limited partnerships, but the structure and jurisdiction of the fund will depend largely on the sponsor and the asset class, geographic focus and anticipated investor base of the fund. It is not uncommon for private equity funds to be organised in jurisdictions outside of the United States (eg, the Cayman Islands). Legal counsel will also work closely with the sponsor as part of the fundraising to prepare the draft limited partnership agreement, investment management agreement, subscription agreement and related fund documents, which are the definitive agreements governing the operation of a private equity fund. Key contractual points in the fund documents will vary on a case-by-case basis, but often include economic arrangements (eg, management fees and carried interest), tax-structuring provisions and minimisation covenants, investment allocation provisions, limited liability protections, standards of care, governance rights, co-investment arrangements, and allocations of expenses.

Following delivery of the fund documents to investors, counsel and the sponsor will work closely with investors to resolve any questions or comments, and once a critical mass of investors' subscriptions has been secured, the fund will hold an initial closing. Fundraising timelines in private equity can vary significantly depending on the sponsor involved and the type and size of fund being raised, running anywhere from a few months to a few years. Once an initial closing has been held, a private equity fund will typically be permitted to hold subsequent closings over a period of 12 to 18 months. As the regulation of private equity funds continues to increase, it will be very important for sponsors to work closely with counsel to ensure that all necessary steps are taken to permit marketing in each jurisdiction in which fund interests are to be marketed.

GTDT: How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

STB: Private equity firms are subject to substantial regulation and supervision in the United States, and the regulatory environment in which private equity firms operate is becoming increasingly complex. The regulation and supervision of private equity firms affects not only the manner in which interests in private equity funds are marketed and sold to investors, but also the day-to-day business and operations of private equity firms themselves.

The principal laws and regulations applicable to private equity firms affecting their day-to-day business and operations include, among others: the Securities Act (affecting the manner in which a private equity fund markets and sells interests to investors), the Securities Exchange Act of 1934 (affecting ongoing reporting obligations and placing practical limitations on the number of investors in s private equity fund), the Investment Advisers Act of 1940 (imposing substantive regulations and reporting provisions on most private equity fund advisers), the Investment Company Act of 1940 (establishing certain eligibility requirements for investors in a private equity fund so that the fund is exempt from registration as an investment company), the Commodity Exchange Act (regulating the ownership of commodities by a private equity fund), and the Employee Retirement Income Security Act of 1974 (imposing restrictions and fiduciary requirements on any private equity fund deemed to hold 'plan assets').

Such laws and regulations substantially impact the day-to-day conduct of a private equity sponsor's business and influence the formation, marketing and management of private equity funds. The regulatory scrutiny of private equity firms has increased substantially in recent years, and regulatory compliance has become an increasingly important and resource-intensive aspect of managing private equity funds in today's environment, which has resulted in increased compliance burdens and has increased the cost of doing business for many private equity sponsors.

GTDT: What effects has the AIFMD had on fundraising in your jurisdiction?

STB: According to recent surveys published by Preqin as recently as July 2014, approximately 71 per cent of US hedge fund managers and 62 per cent of US private equity fund managers believe that the AIFMD will negatively affect the fundraising industry. The most common concern expressed by fund managers with respect to the AIFMD, particularly by smaller fund managers, is the increased cost of compliance associated with the AIFMD. While the AIFMD was introduced with the goal of creating a harmonised pan-European set of rules to increase investor confidence in alternative asset managers by reducing systematic risk and enhancing investor protections, since a number of EU member states have not fully implemented the AIFMD (at the time of publication) or have established local requirements through the adoption of implementing legislation or local private placement regimes that 'gold-plate' the standards imposed by the AIFMD, in practice the AIFMD has caused uncertainty for many non-EU private equity fund managers regarding their ability to 'market' to investors in the EU, which has hindered their ability to raise capital in Europe.

While it is still too early to predict the full weight and impact of the AIFMD on fundraising for US private equity firms, we believe that the AIFMD will meaningfully increase the compliance burdens and costs associated with private equity firms 'marketing' alternative investment funds to non-retail investors in the EU, particularly in light of the recent expiration of the one-year transitional relief period made available by a number of EU member states following the AIFMD coming into force on 22 July 2013, which will likely make it more difficult and costly for private equity firms to 'market' to investors in Europe and may result in a number of US private equity funds, particularly smaller firms that do not have the necessary compliance and fundraising infrastructure in place, deciding not to market in Europe to avoid the additional regulatory burdens and costs imposed by the AIFMD.

The increased regulation imposed by the AIFMD, together with a broader trend towards increasing scrutiny and regulation of private equity firms, has led many private fund managers to adopt increasingly more systematic and integrated compliance operations as part of their overall fundraising activities. We believe that larger established managers with the existing resources and compliance systems in place to absorb the incremental costs and compliance burdens associated with the AIFMD should enjoy a competitive advantage among their peers as smaller firms will likely feel a disproportionate impact on their businesses as a result of the AIFMD.

As US private equity sponsors seek to raise capital from investors in the EU, it will be critical for such sponsors to work closely with legal counsel to establish a 'marketing roadmap' in the EU that is tailored to the sponsor's intended marketing activities and investor base, and to work with counsel to understand how the private placement regimes and local requirements in member states differ across EU jurisdictions. Regulatory compliance is no longer simply a cost of doing business, but rather an integral part of any private equity sponsor's global marketing programme. Fund managers that do not have the resources and counsel necessary to address the additional regulatory and compliance obligations arising out of the AIFMD may find it increasingly difficult to comply with the AIFMD and market funds in the EU, which will likely have a significant impact on fundraising by US private equity firms.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

STB: US tax rules are very complex and tax matters play an important role in both fund formation and the structure of underlying fund investments. Tax issues that have been given particular focus as of late include (i) the implementation of new due diligence, information reporting and withholding


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rules pursuant to the Foreign Account Tax Compliance Act, commonly referred to as FATCA, (ii) possible changes in the taxation of carried interest (as further described below), (iii) expected Internal Revenue Service guidance on the taxation of management fee waiver programmes, and (iv) the proper tax treatment (including deductibility) of monitoring fees paid by underlying portfolio companies to a private equity fund's investment adviser. Consultation with tax advisers with respect to the specific transactions or issues is highly recommended.

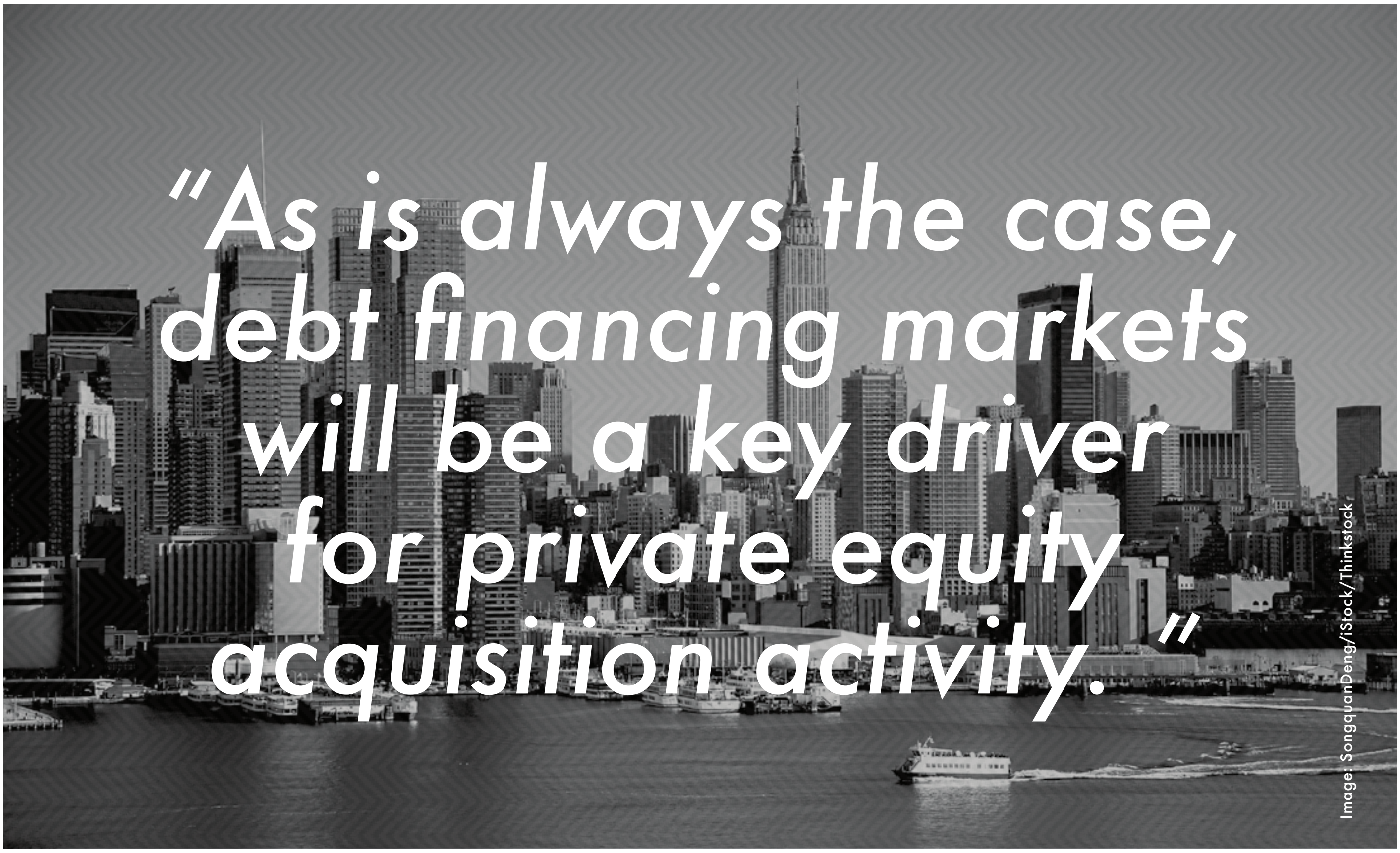
Special consideration is given to structure the carried interest such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (namely, the recipient of the carried interest) and the investment manager (namely, the recipient of the management fee) into separate entities for state tax and other purposes.

Legislation has been introduced in Congress that, if enacted, would result in carried interest distributions that are currently subject to favourable capital gains tax treatment being subject to higher rates of United States federal income tax than are currently in effect. The Obama administration has indicated it supports the adoption of this legislation or legislation that similarly changes the treatment of carried interest for United States federal income tax purposes. Whether such legislation will be enacted (or in what ultimate form) remains uncertain.

GTDT: Looking ahead, what can we expect? What will be the main themes over the coming year?

STB: As is always the case, debt financing markets will be a key driver for private equity acquisition activity. To the extent the credit markets remain strong, we would expect to see continued opportunities for sponsors to put their large amounts of accumulated dry powder to work. Although competition from strategic acquirors will remain high, private equity sponsors will continue to find interesting investment opportunities. Where there is excess dry powder and the credit market remains favourable, private equity investors are increasingly able to remain competitive with strategic buyers. As a case in point, Danaher Corporation lost two auctions to private equity sponsors: the sale of Ashland Inc's water technologies business for approximately US$1.8 billion to Clayton, Dubilier and Rice, and the sale of Johnson & Johnson's diagnostic business to The Carlyle Group for approximately US$4 billion.

We also expect sponsors to continue their exit activity and monetise prior investments during a period where valuations are high. Moreover, so long as stock market valuations remain stable, there may be a continuing trend of portfolio company sales to publicly listed strategic companies for a mix of stock and cash consideration.



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