Private Equity

Contributing editor
Bill Curbow

2018

GETTING THE DEAL THROUGH

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Private Equity 2018

Contributing editor

Bill Curbow

Simpson Thacher & Bartlett LLP

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Preface

Private Equity 2018

Fourteenth edition

Getting the Deal Through is delighted to publish the fourteenth edition of *Private Equity*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Croatia, Israel and Korea. The report is divided into two sections: the first deals with fund formation in 19 jurisdictions and the second deals with transactions in 21 jurisdictions.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Bill Curbow of Simpson Thacher & Bartlett LLP, for his continued assistance with this volume.

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Global overview

Bill Curbow, Atif Azher, Peter Gilman, Fred de Albuquerque and Audra Cohen
Simpson Thacher & Bartlett LLP

Global M&A volume in 2017 fell slightly lower as compared with 2016, finishing at US$3.15 trillion in deal value (representing a 3.2 per cent decrease from 2016), according to Mergermarket. Despite the modest decline, global volume remained strong overall in the context of the past decade, exceeding the $3 trillion barrier for the fourth consecutive year. Global cross-border M&A fell to a three-year low, ending the year at US$1.3 trillion, a 10 per cent decline compared with 2016, marking the slowest year since 2014 (Thomson Reuters). However, buyers were willing to pay more for targets in 2017, with buyers paying an average of 12.32x of a target's EBITDA, compared to an average of only 11.1x in 2016 (Bloomberg). In 2017, global private equity buyouts fared better than overall M&A levels, reaching an annual aggregate deal value of US$346 billion (representing a 10.8 per cent increase from 2016) (according to data provided by Mergermarket). The number of private equity deals increased in 2017 to 2,539 buyouts globally, an approximately 7.4 per cent increase from 2016 (according to data provided by Mergermarket). On the sell side, private equity-backed exits increased with respect to both deal value and deal volume in 2017 to US$362 billion over 1,721 deals, compared with US$352 billion over 1,668 deals in 2016 (according to data provided by Mergermarket). Private equity capital fundraising increased in 2017, with total global fundraising values of US$453 billion, as compared with US$414 billion in 2016 (Preqin).

Americas

Announced M&A deal volume in 2017 in the Americas totalled approximately US$1.4 trillion, reflecting a decrease of approximately 39 per cent from 2016 levels (Bloomberg). Although M&A activity in the US was strong in 2017, deal value in the US declined relative to 2016, totalling US$1.3 trillion, a 15 per cent decrease from 2016, which marks the second consecutive year of decreases in overall value since the record highs of 2015 (Mergermarket). M&A activity in Latin America increased from 2016 levels by 3.6 per cent, reaching US$80 billion in 2017 (Mergermarket). In Latin America, inbound activity, while down 5.3 per cent in value compared with 2016, was responsible for 61.6 per cent of M&A in 2017, accounting for US$49.3 billion over 318 transactions (Mergermarket). US private equity activity remained high overall in 2017 with respect to both the number of deals and aggregate transaction value. For US private equity bidders, total deal value for buyouts ended the year at approximately US$185.86 billion over 1,060 transactions, representing an increase of 33.71 per cent in deal value and an increase of 11.11 per cent with respect to the total number of deals (according to data provided by Mergermarket). In addition, private equity sponsors continued to focus their M&A activity on add-on acquisitions, which accounted for 37 per cent of all private equity-backed buyout deals in 2017 (Preqin). Notable add-on acquisitions in 2017 included Kohlberg Kravis Roberts & Co's (KKR) acquisition of American Medical Response from Envision Healthcare Corp for US$2.4 billion, which KKR has stated it plans to combine with its existing portfolio company, Air Medical Group Holdings, and the acquisition of BKC Insurance Agency by The Hilb Group, a portfolio company of ABRY Partners, for an undisclosed amount. Notable completed private equity acquisitions in the Americas included the acquisition of Panera Bread for US$7.16 billion by BDT Capital Partners, who invested alongside JAB Holding Company; Sycamore Partner's US$6.9 billion buyout of Staples, Inc; and the US$3.2 billion acquisition of Diversey Inc by Bain Capital LLC.

Europe, Middle East and Africa

Announced M&A deal volume in Europe, the Middle East and Africa (EMEA) totalled approximately US$969.4 billion in 2017, an increase of approximately 9.4 per cent from 2016 volume (Mergermarket). Europe accounted for approximately US$929.3 billion of total announced M&A deal volume, up 14 per cent from 2016 (Mergermarket). However, M&A volume involving the Middle East and Africa fell to US$59.4 billion, a 34.2 per cent decrease compared with 2016 volume (Mergermarket). In 2017, private equity deals in EMEA increased by 30.3 per cent compared with 2016, with deal volumes reaching their highest levels in the past decade (Bloomberg). On par with last year, there were 11 mega-deals announced, worth a combined US$254.2 billion (Mergermarket). European-targeted buy-side financial sponsor activity increased 34.34 per cent year-on-year to US$153.24 billion. Private equity sponsors achieved US$107.84 billion of exit activity for targets located in Europe, which represented a 4.47 per cent increase compared with 2016 levels. In the Middle East and Africa, inbound M&A volume decreased by 34.21 per cent from 2016 levels to US$59.43 billion, with US investments into the region worth US$25.63 billion over 51 deals (according to data provided by Mergermarket). Notable announced and completed European private equity transactions in 2017 included the announced €6.825 billion acquisition of Unilever's margarine and spreads business by KKR; the acquisition of Alight Solutions from Aon Hewitt LLC by the Blackstone Group for US$4.8 billion; Hellman & Friedman's US$5.2 billion acquisition of Nets A/S, Scandinavia's largest payments processor; the approximately €4 billion acquisition of Visma led by HG Capital, which also included Cinven and Montagu; Lone Star Fund's approximately €2.2 billion acquisition of Xella International; and the approximately US$2.3 billion acquisition of the Mauser Group by Stone Canyon Industries.

Asia–Pacific

Announced M&A deal volume in the Asia–Pacific region, excluding Japan, totalled approximately US$673.5 billion in 2017, which represented an increase of approximately 4.8 per cent from comparable deal volume in 2016, with the overall 2017 volume reaching its second highest point since 2001. Announced M&A deal volume in Japan totalled approximately US$40.1 billion, representing a decrease of approximately 36.4 per cent from 2016 levels (Mergermarket). Private equity activity in Asia–Pacific increased by 37.7 per cent in 2017 to $122.7 billion. China's outbound activity was down to US$141.5 billion over 862 deals in 2017, a decrease of 6 per cent in volume and a decrease by 35 per cent in value from 2016 levels (Thomson Reuters). Asia–Pacific outbound acquisition deal volume also experienced a decline of 54.1 per cent as a consequence of China's increased regulation of capital invested outside of its borders. Inbound activity in Asia–Pacific increased by 21.9 per cent to US$107.6 billion over 603 deals compared with US$88.3 billion over 585 deals in 2016. Private equity sponsor exits of targets located in the Asia–Pacific region totalled US$44.08 billion, which represented a decrease of approximately 7.41 per cent from 2016. In Japan, the value of private equity buyouts soared to US$16.06 billion, representing a 109.93 per cent increase compared with 2016. Private equity exits of targets located in Japan also saw a significant increase of 130.64 per cent above 2016 total deal value, with deals valued at an average of approximately US$3.99 billion in 2017 (all of the above data provided by Mergermarket). Notable private equity transactions

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in the Asia–Pacific region included the approximately US$18 billion acquisition of Toshiba Memory Corporation by a Bain Capital-led consortium that included Apple Inc, Dell Inc, Hoya Corporation, Kingston Technology Company Inc, Seagate Technology Holdings, SK Hynix and Toshiba Corporation; the US$6.8 billion acquisition of Belle International by a consortium of private equity buyers led by Hillhouse Capital and CDH Investments; and the announced S$16 billion acquisition of Global Logistic Properties Limited by a private equity consortium that includes Bank of China Group Investment, China Vanke Co Ltd, Hillhouse Capital Management, Hopu Investment Management and Schwartz-Mei Group Limited.

Debt-financing markets

In 2017, leveraged M&A loan volume saw a healthy increase of 15 per cent to US$311 billion from 2016 levels. Leveraged buyout loan volume as a percentage of overall M&A leveraged volume also saw an increase and was up 41 per cent compared with 32 per cent of overall M&A leveraged volume in 2016 (Thomson Reuters). One notable trend of 2017 was that lending in the middle-market increased to US$170 billion, a 23 per cent increase over 2016, which marked the highest middle-market lending has been in three years (Thomson Reuters). Median debt percentages for private equity buyouts and M&A in the US increased to 53 per cent of enterprise value in 2017, up from 50.5 per cent in 2016, while median enterprise value remained unchanged at 10.5x EBITDA for M&A transactions (including buyouts) in 2017 (Pitchbook). Debt to EBITDA multiples over the course of 2017 increased to 5.7x compared with 5.5x in 2016 (Pitchbook). Middle-market debt multiples are at a historic high entering 2018, with average total debt on structures with second liens or sub-debt increasing to 6.11x of EBITDA, up from 5.27x in 2016, and senior debt also increased to 4.5x of EBITDA, up from 3.9x in 2016 (Axios).

Portfolio company sales and IPOs

Portfolio company exits by private equity sponsors increased slightly during the past year. Global financial sponsors exited approximately US$362 billion of investments, which represented a 2.87 per cent increase from 2016 levels (according to data provided by Mergermarket). Strategic acquisitions remained the primary exit route, representing 54 per cent of all private equity-backed exit volume (Preqin). In 2016, the private equity market saw an increase in secondary buyout activity with a volume of US$65.2 billion, accounting for a 26 per cent share of global financial sponsor exit volume (Preqin). The US led total financial sponsor exits with US$185 billion over 1,097 transactions, a decrease of 16.67 per cent from US$222 billion over 1,238 transactions in 2016 (Pitchbook).

Notable completed portfolio company sales in 2017 included the €12.25 billion sale of Logicor by Blackstone to China Investment Corporation; the US$7.5 billion sale of AWAS Aviation Capital by Terra Firma and Canada Pension Plan Investment Board to Dubai Aerospace Enterprise; the €5.76 billion sale of Quironsalud by CVC Capital Partners to Fresenius SE; the US$5.5 billion sale of Capsugel by KKR to Lonza Group AG; and the US$4.6 billion sale of inVentiv Health by Advent International and Thomas H Lee Partners to INC Research Holdings, Inc (Pitchbook).

Globally, financial sponsor-backed IPOs and follow-on offerings accounted for 12 per cent of all exits in 2017 (Preqin). In the US, private equity-backed companies completed 45 IPOs in 2017, an increase from the 34 private equity-backed IPOs in 2016; however, the total completed IPOs for the past couple of years are still down from the previous peak of 75 private equity-backed IPOs that were completed in 2014 (Pitchbook). By the end of the year, total proceeds from such offerings in the US were approximately US$13.4 billion, an increase of 52.27 per cent from US$8.8 billion in 2016. The increase reflected a general increase in overall IPO markets, with overall IPO activity up 39.55 per cent from 2016. In 2017, there were approximately 374 IPOs with a deal size of at least US$100 million with a total value of approximately US$141.4 billion, up 39.55 per cent in activity and 33.02 per cent in value from 2016. The median dollar amount raised in 2017 was US$207.2 million, an increase of 11.46 per cent from US$185.9 million in 2016 (all of the above data provided by Renaissance Capital as of 15 December 2017). However, even though overall IPO activity increased in 2017, financial sponsor-backed IPOs saw a decline in terms of proportion of global IPOs, falling to 9.7 per cent, down from 13 per cent in 2016 (Ernst and Young Global).

Notable private equity portfolio company listings in 2017 included the listing of Invitation Homes Inc on the New York Stock Exchange raising approximately US$1.54 billion, a holding of Blackstone Group LP; the listing of Antero Midstream GP LP on the New York Stock Exchange raising approximately US$875 million, a holding of Warburg Pincus LLC and Trilantic Capital Management LP; and the listing of Gardner Denver Holdings, Inc on the New York Stock Exchange, which raised approximately US$826 million, a holding that included KKR (Renaissance Capital).

Strong year in private equity fundraising

Overall, 2017 was a record year for private equity fundraising, surpassing levels from recent years to reach an all-time fundraising record for the private equity industry. Fundraising by recognised, top-performing sponsors has remained strong and reflects continued consolidation within the private equity fundraising market in favour of such established sponsors with proven track records. Capital raised by private equity funds globally totalled approximately US$453 billion, up approximately 9 per cent from the US$414 billion raised globally in 2016 (all statistics herein provided by Preqin). Notably, private equity fundraising in 2017 was driven by the resurgence of mega-funds, as 28 per cent of the private equity capital raised in 2017 was raised by the 10 largest funds closed and 42 per cent was raised by the 20 largest funds closed.

Overall, conditions for private equity fundraising are at an all-time high, and competition among fund sponsors continues to increase. The number of private equity funds closed in 2017 dropped by approximately 26 per cent globally with the average size of today's private equity funds increasing to a record of US$535 million. These trends reflect the continued consolidation in the private equity industry in favour of larger, established sponsors with proven track records as a result of institutional limited partners seeking to make larger commitments to fewer funds and consolidate manager relationships.

The continued strength of global fundraising has increased the amount of 'dry powder' accumulated over the past few years to record levels, reaching US$1 trillion by the end of 2017. Robust private equity-backed exit activity, at often record pricing, with distributions to investors reaching record levels in recent years (surpassing capital calls for the seventh successive year) provided an additional source of ongoing liquidity for investors and, coupled with the stability and outperformance of private equity relative to the public markets, has led many investors to seek to redeploy such amounts back into private equity by making new or additional commitments to private equity funds, further accelerating the growth in dry powder in 2017. Despite the record levels of capital available to invest, the increased market prices are a concern for fund managers as they face an increased challenge in deploying such excess capital, which is likely to cause fund managers to get more creative in their efforts to deploy capital.

It is expected that overall fundraising levels will remain strong in the near term and that the records, trends and developments witnessed in 2017 will continue. Larger institutional investors will continue to consolidate their relationships with fund managers and competition for limited partner capital among private equity funds will continue to increase, with alternative fundraising strategies (eg, customised separate accounts, co-investment structures, early-closer incentives, 'umbrella' funds, 'anchor' investments, 'core' funds and 'complementary' funds (ie, funds with strategies aimed at particular geographic regions or specific asset types)) playing a substantial role. As a result, established sponsors with proven track records should continue to enjoy a competitive advantage and first-time funds will need to cater to investors by either lowering fees, expanding co-investment allowances, focusing on niche investment opportunities or exploring other accommodative strategies. It is also expected that the SEC will continue to focus on transparency (eg, pre-commitment disclosure and consent from investors) with respect to conflicts of interest (including, among others, conflicts of interest arising out of the allocation of costs and expenses to funds and portfolio companies, the allocation of investment opportunities and co-investment opportunities and the receipt of other fees and compensation from funds, portfolio companies or service providers). Given this, larger private equity firms with the resources in place to absorb incremental compliance-related efforts and costs are likely to continue to enjoy a competitive advantage among their peers.

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Outlook for 2018

Practitioners are optimistic that global M&A levels will increase in 2018 relative to overall 2017 levels owing to strong deal flow in the fourth quarter of 2017, which posted the highest quarterly volume for the year, including five mega-deals valued at over US$10 billion each in December alone. Some expectation of sustained M&A activity is in part the result of the significant amount of cash sitting on corporate balance sheets to be utilised in effecting acquisitions and investments. In addition, the passing of the Tax Cuts and Jobs Act in the US at the end of 2017 erased some of the uncertainty in the market regarding what new tax legislation might encompass. This should allow corporates and private equity sponsors to turn back to deal-making, while encompassing their analysis of the effects of the Tax Reform Bill into valuation models and strategic decision-making.

With respect to private equity investment activity, many commentators expect deal flow to remain healthy and roughly consistent with or slightly above 2017 levels. The current state of the global economy, certainty around the US Tax Reform Bill and high 'dry powder' levels are anticipated to be catalysts for increased deal activity. A continuing challenge for private equity firms in the US is finding attractive investment targets owing to the relative lack of supply of buyout-ready companies coming to market compared with previous periods, alongside pressure to deploy significant levels of committed capital (approximately US$1 trillion of dry powder globally at the end of 2017, according to Preqin). In response to sustained high valuations, some commentators predict that 2018 will also see sponsors continuing to explore new and creative methods of deploying capital, in addition to the prominent focus on add-on acquisitions, in order to harness synergies and find other ways to achieve returns on investment. Some methods might include minority investments, forming joint ventures, teaming up with strategic buyers or investing in debt, hybrid or other instruments at different levels of the capital stack.

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Australia

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Historically, Australian private equity (PE) funds have been established in the form of a unitised trust. This vehicle is not commonly used in overseas jurisdictions and contains concepts foreign to many investors. Over the past 15 years, the Australian PE fund landscape has changed dramatically, first with the introduction of the venture capital limited partnership (VCLP) and early stage venture capital limited partnership (ESVCLP) regimes and, more recently, the managed investment trust (MIT) and attribution MIT (AMIT) regimes (MITs and AMITs are forms of unit trusts), largely to make the industry more attractive to investors (and in particular, foreign investors).

Unit trusts

A unit trust, managed by a trustee, manager, or both, is a contractual (and fiduciary) relationship created between the unitholders (investors and beneficiaries) and the trustee (legal holder of the property and manager) under a trust deed or constitution. The trustee generally has the right to deal with the assets of the trust in accordance with the terms of the trust deed governing the trust for the benefit of investors, and often appoints a management entity within the structure to advise the trustee, mainly for fee-streaming purposes.

The unit trust is not a separate legal entity and the trustee contracts on behalf of the trust, subject to a contractual term generally limiting liability of the trustee to the assets of the trust.

See question 17 regarding the tax treatment of unit trusts.

VCLPs and ESVCLPs

The VCLP regime was introduced to increase foreign investment in the Australian venture capital sector by offering a familiar fund structure (the limited partnership) with tax benefits (see question 17 regarding the tax treatment of VCLPs) in exchange for making investments in Australian businesses that meet certain eligibility criteria.

A VCLP is a separate legal entity and can contract on this basis.

The use of VCLPs has been limited to venture capital and mid-market private equity funds because of the restrictions on the types of investments that VCLPs can make. For example:

- the investment must be in shares or options in a company or units in a trust;
- the target must have an Australian nexus (subject to limited exceptions);
- the target must generally be an operating entity or its holding company; and
- the target must not have total assets (including goodwill) of more than A$250 million.

VCLPs need a minimum raising of A$10 million from investors to be established and registered and have a life of five to 15 years. There is no maximum size restriction for VCLPs.

The ESVCLP is essentially an extension of the VCLP regime. It was introduced to encourage early stage venture capital investment by offering further taxation advantages for investors (see question 17 regarding the tax treatment of ESVCLPs) provided the fund only invests in early stage investments and meets certain other tests – these are similar to the restrictions applying to VCLPs except that the target must not have total assets (including goodwill) of more than A$50 million and there are different restrictions on investing in pre-owned shares and listed entities. Despite these restrictions, the ESVCLP structure has gained popularity with high net worth investors who value the tax advantages offered by the ESVCLP and want exposure to early stage venture capital. An ESVCLP's fund size is capped at $200 million.

MITs

The MIT regime addresses issues surrounding uncertainty about the tax treatment of gains made by unit trusts. See question 17 regarding the tax treatment of MITs.

An MIT is a unit trust (as described above) that has certain characteristics. To qualify as an MIT, a number of tests must be met, including the following:

- the trustee must be an Australian resident for tax purposes;
- the trust must not be a trading trust (that is, a trust that carries on, or controls an entity carrying on, an active business);
- a substantial proportion of the investment management activities carried out in relation to the trust throughout the income year must be carried out in Australia in relation to certain assets (this requirement is only relevant for the MIT withholding regime, which is described below);
- the trust must be a 'managed investment scheme' for Corporations Act purposes at the time the payment is made;
- the unitholding must be widely held and satisfy concentration of ownership requirements; and
- in certain cases, the trust must be operated or managed by a licensee holding an Australian financial services licence (AFSL) whose licence covers it providing financial services to wholesale clients.

The AMIT regime was introduced in May 2016, with effect from 1 July 2015. An elect-in regime, these rules, among other things, make the following available to eligible AMITs:

- a new attribution method (rather than the existing trust tax rules) to attribute specific classes of income, offsets and credits to unitholders, based on their entitlements;
- the ability to attribute any under or over distributions to unitholders during the income year the discrepancy is discovered;
- tax treatment as a fixed trust, assisting the flow through of franking credits and carried-forward tax losses; and
- the ability of unitholders in the AMIT to adjust their tax cost basis in their units so as to avoid double taxation.

In order to be eligible as an AMIT:

- a trust must be an MIT (described above);
- the trust deed must clearly define the entitlements of all unitholders to the trust's income and capital; and
- the trustee is under an obligation to treat all members of the same class equally and members of the different classes fairly.

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These eligibility requirements must be met for each income year. Should the requirements not be satisfied, the normal rules relating to the taxation of trusts and MITs will apply.

CCIV and LPCIV

The Australian government is currently consulting on a form of incorporated collective investment vehicle referred to as the CCIV. Consultation is also expected in the near future on a limited partnership collective investment vehicle. It is not yet known when these structures will be available for use, but they are expected to be attractive vehicles for PE funds.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

Fund formation is taking a well-trodden path in Australia. The typical process can be broken down as follows:

Fund formation process	
Month 1	Lawyers appointed
	Decide fund size
	Draft term sheet
	Decide on key message
	Set up electronic data room
	Decide budget
Month 2	Decide on international strategy (if any)
	Tax advisers appointed
	Finalise pitch document
	Draft Private Placement Memorandum
	Due diligence
	Find investment committee members
Month 3	Draft fund structure and documents
	Negotiate fund documents (including side letters)
Month 4	First close

The timetable can vary greatly depending on the reputation and track record of the manager and the appetite of investors for exposure to the assets being targeted, but generally a four-month period is typical from the establishment phase to first close.

Financial, tax and legal advisers will generally play a very significant role in fund structuring and ensuring compliance with the applicable laws.

The key process revolves around the settling of the fund terms and discussions and negotiations with investors. The fund documentation, while involved and complex, has become reasonably standardised across Australian PE funds for similarly structured funds (although the terms can vary widely from one fund to the next).

Once documentation is settled for the structure, there are limited public registration filings.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A private equity fund vehicle formed in Australia could have a domestic or international PE fund manager, although to access the concessional tax treatment afforded by the VCLP, ESVCLP, MIT and AMIT regimes the specific requirements associated with those regimes must be complied with (for example, the MIT regime requires that the trustee of the trust be an Australian resident for tax purposes).

A PE fund manager that carries on a financial services business in Australia will generally be required to hold an AFSL, which will set out the authorised activities that the manager may undertake. Depending on the circumstances, the licensed entity may be the manager of the fund, the trustee of the trust or general partner of the VCLP or ESVCLP. Many international PE funds that do business in this jurisdiction may be able to take advantage of certain licensing relief where they have only limited ties to Australia or where Australia and their home jurisdiction have specific 'passporting' arrangements in place.

A domestic fund manager will generally have a head office in Australia, be structured as a proprietary limited company (which requires at least one resident director) and have a company secretary. Apart from the compliance requirements associated with AFSLs, limited financial records and statutory registers are required to be kept.

VCLPs and ESVCLPs are able to hold assets directly, but in the case of trusts (including MITs and AMITs), trustees hold the title and, where they have more than 20 clients, may need an AFSL with a custody authorisation to enable them to do so. Alternatively, a licensed custodian can be hired to provide this service to the fund. Where the trustee has fewer than 20 clients, there are some exemptions from the requirement for a fund manager to either hold an AFSL with an authorisation to provide custody services or use an external custodian.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Very little information is available to the public relating to typical PE fund structures in Australia.

Owing to the fact that investors are predominantly institutional or wholesale, there are no registration requirements for the fund or those investors and no disclosure obligations imposed by law relating to funds or fund investments.

If the fund is registered as a VCLP or ESVCLP, the name of the fund is publicly available on a government website; limited information relating to the identity of investors may be requested through a business regulator in this jurisdiction on payment of a fee; and information about investments must be reported to a government regulator to verify compliance with the investment limitations applying to the VCLP or ESVCLP regime (as applicable) (but this investment information is not available through any public forum).

The AFSL laws in Australia require the licensed entity (which as noted above may be the manager of the fund, the trustee of the trust or general partner of the VCLP or ESVCLP) to have their accounts audited and lodged with our regulator (the Australian Securities and Investments Commission (ASIC)), but these are the accounts of the manager, trustee or general partner entity (as the case may be) and often, essentially, pro formas evidencing minimum capital requirements to the extent required under the licensing laws here.

The specific terms of the AFSL are also publicly available.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

In the case of trusts (including MITs and AMITs), it is typical to provide in the trust deed that beneficiaries will not be liable for any amount beyond the amount subscribed to the trust (or which they are legally obliged to subscribe). Whether limitations of that kind are effective (other than in the case of fraud or the like) has yet to be tested before the courts in Australia. There is case law that suggests that the liability of beneficiaries may be excluded by express provision in the trust deed, provided the loss did not arise from a breach of trust committed by the trustee at the request or instigation of the beneficiary in circumstances that would entitle the trustee to hold the interest of that beneficiary as security against personal liability of the trustee for that loss.

Because VCLPs and ESVCLPs are incorporated entities, the limited liability of third-party investors will be respected in the same manner as shareholders in a corporation.

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6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Duties of managers, general partners and trustees of private equity funds arise in many respects. There are duties to act in the best interests of members arising at law for the trustee of a trust, enforceable against that trustee. These duties will usually be reinforced through the trust deed establishing the trust.

The general partner of a VCLP or ESVCLP has duties arising under the terms of the partnership deed governing the VCLP or ESVCLP (as applicable), which generally reflect the legal duties of a trustee to act in the best interests of members (or in this case, limited partners).

The AFSL imposes duties on the licensed entity to act efficiently, honestly and fairly, effectively extending duties of a fiduciary nature from the licensed entity to investors.

While the legal fiduciary duties cannot be contracted out of, the terms of the relevant trust deed or partnership deed may amend or modify those duties to provide for terms agreed between the investors and the sponsor.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Owing to the most recent case law in Australia on the subject, it is generally accepted that there is no legal distinction to be made between the concepts of negligence and gross negligence.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are no special issues or requirements under Australian law other than as described in this chapter. Funds raised outside of Australia by Australian fund managers are affected by regulatory changes in other jurisdictions, for example in the US (in particular the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)) and the EU (in particular the directive on alternative investment fund managers (AIFMD)).

Generally, there is no facility for redomiciling a limited partnership to this jurisdiction.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

In an insolvency event, the general partner or trustee and the manager will be required to retire under typical Australian PE fund constituent documents. An insolvency event and change of control or key person of the fund manager will also typically constitute a capital call relief event.

Under the terms of the AFSL, the licensed entity needs to remain solvent and have positive net assets to keep its licence.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

ASIC is the principal regulatory authority that has oversight of the operation of PE funds in this jurisdiction. Through the AFSL licensing regime, licensed entities are required to prepare and publicly lodge audited accounts and comply with stringent ASIC requirements relating to compliance and compliance auditing. ASIC has the right at any time to inspect books and records of a licensed entity in relation to their compliance with these provisions of the Corporations Act. Innovation and Science Australia is the government agency responsible for registering incorporated limited partnerships as ESVCLPs or VCLPs (as applicable).

In late 2011, the Australian Private Equity & Venture Capital Association Limited, being a body established to represent and promote the interests of the private equity and venture capital industries in Australia, released a code of private equity governance. The code sets out principles and guidance to inform decisions about how Australian PE funds and their portfolio companies might be better governed. While compliance with the code is not compulsory for managers, general partners and trustees, we believe investors will expect that managers, general partners and trustees follow the principles set out in the code and report to investors where they have not followed those principles.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Most private equity funds target predominantly institutional or wholesale investors, meaning there are no registration requirements for the fund per se under the corporations legislation. If a private equity fund were to target retail investors, however, the Australian regulations would require the fund to be registered and the constituent documents to comply with strict requirements.

VCLPs and ESVCLPs established in Australia must be registered as an incorporated limited partnership in a particular state and as a VCLP or ESVCLP with the federal government body that oversees the VCLP and ESVCLP regimes.

The trustee of an MIT must elect for the trust to be treated as an MIT and, similarly, the trustee of an AMIT must elect for the trust to be treated as an AMIT (although this latter election can be evidenced in the way in which the tax return for the AMIT is prepared).

Otherwise, the AFSL requirements described in this chapter are the chief licensing requirements applicable to fund managers.

In some circumstances, a foreign investor may require approval to invest into an Australian-domiciled private equity fund under Australia's foreign investment laws.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Yes, the AFSL registration requirements as described in this chapter need to be satisfied.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Yes, under the terms of the AFSL, the entity managing the fund must have organisational capacity and relevant experience with dealing in and advising on securities to wholesale clients at a minimum. These

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requirements set out detailed tests that need to be satisfied by the persons responsible for the day-to-day management and operation of the PE fund.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

Regarding political donations, the PE industry is largely unregulated in Australia as a separate industry, although there are laws that regulate and sometimes prohibit (for example, in the case of property development) the making of political donations and the reporting of those donations by political parties.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

As Australian super funds are one of the major investors in this jurisdiction, the level of reporting has in large part been dictated by their requirements (which vary from fund to fund).

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There has been no specific legislation regulating banks' investment or sponsoring of PE funds in Australia, but particularly relevant for US banks operating in Australia, or potentially Australian banks operating in the US, the enactment of the US Dodd-Frank Act has dramatically changed the regulatory landscape for all US financial institutions, and potentially non-US financial institutions that have any dealings with the US or US entities. One of the many sweeping regulatory changes implemented by the Dodd-Frank Act is the implementation of the Volcker Rule. The Volcker Rule prohibits US banks and certain non-bank financial institutions from investing in or sponsoring hedge funds and private equity funds on a proprietary basis, except in certain limited respects. In addition, the Dodd-Frank Act has empowered the US Federal Reserve with the authority to set rules for prohibiting the investment in or sponsoring of hedge funds and private equity funds.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

The typical private equity fund structures referred to above are generally flow-through vehicles, in that the income and profits of the fund structure are generally taxed in the hands of the investor (however, see comments below regarding MIT withholding tax (MITWHT) and withholding tax on dividends and interest paid to non-residents).

Many fund structures use combinations of the different structures and a combination of the Australian tax considerations outlined below may therefore apply.

Subject to the special rules described below, gains made by private equity funds are generally treated as being of an income character (as opposed to being of a capital nature) unless it can be established that the particular fund intended to derive income in the form of regular returns during the period of holding (rather than merely gains on disposal).

Trusts generally

Unitholders in a trust are generally taxed on their share of the taxable income of the trust determined using the proportion of the accounting income of the trust to which they are presently entitled. The trustee of the trust is required to pay tax on income to which a non-resident unitholder is presently entitled, but that unitholder gets a credit for the tax paid by the trustee and can obtain a refund of the trustee tax if it is excessive in the circumstances.

Withholding tax will apply to distributions to non-resident unitholders that derive from unfranked dividends and royalties (generally 30 per cent) and interest (generally 10 per cent). The applicable withholding tax rate may be reduced under an applicable double tax agreement (DTA).

Where a trust carries on an active business or controls a company that carries on an active business, the trust can itself be treated as a company in some circumstances. The Australian Taxation Office (ATO) has taken an initial view that a power to veto could amount to control for these purposes. As this outcome is contrary to a principal objective of using a trust, these rules should be carefully considered and applied.

Losses made by a trust are quarantined within the trust and do not flow to unitholders. The losses may be used by the trust in future years provided various trust loss rules are satisfied.

MITs

A trust that is an MIT is able to make an election to deem certain gains made by the MIT to be on capital account (rather than the default revenue character described above). This means that Australian investors may be able to access concessional tax rates for capital gains and non-resident investors will generally not have any Australian income tax liability unless the relevant capital gain made by the MIT is in relation to taxable Australian property (eg, interests in land and non-portfolio interests in land-rich entities) or the non-resident investor has a permanent establishment in Australia.

Subject to meeting certain additional requirements, distributions to non-residents by an MIT of certain taxable amounts may qualify for MITWHT at a 15 per cent rate (depending on the nature of the income distributed (see below for details) and the tax residence of the investor). However, where the investor is a resident of a country other than an 'information exchange country' (as defined by income tax regulations), the applicable rate of MITWHT is 30 per cent. A 10 per cent rate may be available for eligible distributions by MITs that hold only certain energy-efficient buildings constructed from 1 July 2012.

This withholding tax will apply to various distributions, including distributions of taxable capital gains (namely, capital gains derived in relation to taxable Australian property) and income that has an Australian source (such as rental income in relation to land situated in Australia).

Because Australian resident investors are taxed by assessment, an MIT does not generally need to withhold from amounts paid to Australian resident investors.

AMITs

Whereas the unitholders in a trust are generally taxed on a proportionate basis on the income of the trust, the AMIT regime allows for income of a particular character to be attributed to particular unitholders in accordance with their 'clearly defined rights to income and capital' in the trust deed. The rules also allow for various other benefits, such as dealing with unders and overs in the income year in which they are discovered, deeming of the AMIT to be a fixed trust (which assists with the flow through of franking credits and carried-forward tax losses) and the making of adjustments to the cost base of units to avoid double taxation for unitholders.

VCLPs

Where a VCLP is used as the fund vehicle, subject to certain exceptions, both income and losses are attributed to investors. Australian

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investors will need to include the relevant partnership profit in their assessable income or claim the corresponding deduction for any loss. Subject to an exception that applies to certain superannuation investor entities and unlike MITs, the gains made by a VCLP are not deemed to be made on capital account, and so such gains may be made on revenue account (and not be concessionally taxed as capital gains).

Certain non-resident investors (such as tax-exempt foreign residents, foreign venture capital fund of funds with no more than 30 per cent of the VCLP's committed capital and other foreign investors with less than 10 per cent of the VCLP's committed capital) are given a specific exemption from Australian income tax on gains made in relation to investments held by the VCLP. If a non-resident investor does not satisfy the exemption criteria, it may have an Australian income tax liability in relation to gains made by the VCLP.

There is no withholding tax on distributions of gains on investments made by a VCLP to non-residents.

Unfranked dividends or interest derived by the VCLP and paid to a non-resident investor are subject to withholding (generally 30 per cent in the case of an unfranked dividend or generally 10 per cent in the case of interest (subject to the operation of any applicable DTA)).

Because Australian resident investors are taxed by assessment, generally no amount needs to be withheld from amounts paid to them.

ESVCLPs

Where an ESVCLP is used as the fund vehicle, subject to certain exceptions, both Australian investors and foreign investors may be entitled to tax-free returns from the ESVCLP.

Key tax features of the ESVCLP regime for investors include the following:

- a non-refundable offset of up to 10 per cent of a limited partner's contributions made on or after 1 July 2016 to an ESVCLP that becomes unconditionally registered on or after 7 December 2015;
- a limited partner's share of any gain or profit from the disposal or realisation of an eligible venture capital investment by the ESVCLP is exempt from Australian income tax, if the partnership owned the investment for at least 12 months; and
- a limited partner's share of income derived from an eligible venture capital investment (for example, dividends paid by an investee) held by the partnership is exempt from Australian income tax. Unfranked dividends or interest derived by the ESVCLP and paid to a non-resident investor are subject to withholding (generally 30 per cent in the case of an unfranked dividend or generally 10 per cent in the case of interest (subject to the operation of any applicable DTA)).

Losses made by an ESVCLP are typically not deductible to investors.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

A foreign investor in an MIT (which has made a capital account election) will generally not, in relation to gains made by the MIT, have to pay any Australian income tax and will not have any income tax filing obligations if the fund does not hold taxable Australian property and the non-resident investor does not have a permanent establishment in Australia (see question 17). As noted above, the trust may have a MITWHT or dividend or interest-withholding tax obligation on certain payments made to the non-resident, but these are final taxes that do not require the non-resident to lodge a tax return.

Where a VCLP or ESVCLP derives a gain on the disposal of investments, the non-resident investor will generally not have any Australian income tax and income tax-filing obligations where the foreign investor falls within the relevant exemption categories under the VCLP or ESVCLP rules (as applicable) (for example, where the foreign investor holds less than 10 per cent of the VCLP's committed capital). Otherwise, they will need to consider whether they have a liability to Australian income tax and tax-filing requirements if the gain is not on capital account. As noted above, dividend or interest-withholding tax obligations may exist in relation to certain payments made to the non-resident, but these are final taxes that do not require the non-resident to lodge a tax return.

If a non-resident disposes of certain interests (including shares in a company or units in a trust), the value of which is predominantly derived from Australian land, the purchaser will be obliged to withhold 12.5 per cent of the proceeds from the sale. It should be noted that not only does this withholding apply to the taxation of capital gains, it also applies where the disposal of the relevant asset is likely to generate gains on revenue account, and therefore be taxable as ordinary income rather than as a capital gain. This withholding is not levied as a 'final' withholding tax.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Taxation rulings are typically not sought on the fund structure (however, there are exceptions, particularly in relation to ensuring MIT or AMIT status or in relation to sovereign investors). Relevant differences in the income tax treatment between resident and non-resident investors have been highlighted above. In some situations, it may be preferable to obtain an advance ruling on the extent to which gains of a fund are protected by treaties based on the residence of the ultimate investors, especially where other concessions discussed above are not applicable.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

No significant organisational income taxes are generally payable except as discussed above.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Carried interests in MITs are specifically deemed to be on income account by the tax law and will not be concessionally taxed as capital gains. On the other hand, carried interests of a general partner in VCLPs and ESVCLPs are specially deemed to be on capital account and are concessionally taxed as capital gains.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Australia has comprehensive DTAs with countries including Argentina, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Fiji, Finland, France, Germany, Hungary, India, Indonesia, Ireland, Italy, Japan, Kiribati, Korea, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Papua New Guinea, the Philippines, Poland, Romania, Russia, Singapore, Slovakia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Turkey, the United Kingdom, the United States and Vietnam. These largely follow the OECD approach to the allocation of taxing rights.

The interaction between Australia's DTAs and the taxation of partnerships and trusts is complex. However, we make the following general observations:

- withholding tax rates on distributions of interest and dividends to non-resident investors in an MIT or VCLP have been considered briefly above (it should be noted that the rate of withholding on interest, royalties and dividends may be reduced by the terms of the relevant DTA);
- in relation to gains made by a VCLP or MIT, this interaction should largely be irrelevant (from an Australian income tax perspective) where the MIT does not make any gains on taxable Australian property (and the relevant foreign investor does not have a permanent establishment in Australia) or where the foreign investor in the VCLP falls within one of the exemption categories noted previously; and

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- a recent decision of the Full Federal Court has considered the application of treaty protection in circumstances where a fund with predominantly treaty-resident investors is established in a low tax jurisdiction. In that decision, the Court held that the ATO was not precluded from issuing a tax assessment on a limited partnership realising a gain on an interest in Australian land by operation of the relevant DTA.

In addition, Australia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument) in 2017, which, once ratified, will modify most of Australia's bilateral tax treaties to implement measures designed to address multinational tax avoidance.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

There is increasing sensitivity to the use, by investors, of entities located in tax havens, the requirement for interposed entities to have substance and on the risk profile of related party financing arrangements. The issue of control of active businesses is also an issue that has come under recent scrutiny, particularly where fund structures convey 'negative control'.

Where an investment by a foreign person is subject to Australia's foreign investment laws, it is not unusual to have tax conditions imposed on the investment to ensure compliance with tax laws. The ATO uses this process to obtain additional information on tax matters associated with the transaction and any existing investments.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

In Australia, wholesale investors (persons investing more than A$500,000) and institutional and professional investors are the investors typically targeted by PE funds. Australian law does not require disclosure to these parties for issues of interests in PE funds.

If any offers of interests are made in a PE fund (domestic or international) to Australian investors who are retail persons (not wholesale), the fund manager will need to be comfortable that an exemption to the disclosure requirements applies (among other exemptions, offers to no more than 20 people in any 12-month period for a raising of no more than A$2 million will be exempt). Otherwise a prospectus or product disclosure statement will need to be issued and registered with ASIC.

If issues of interests in the PE fund are to retail persons, the fund will also need to be registered and additional licensing (and financial) requirements will apply to the fund manager.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

None; however, the identity of the investors will have implications for the compliance obligations imposed by the Corporations Act and the tax treatment likely to be afforded to the PE fund (ie, whether the investors will be entitled to rely on a relevant DTA).

Update and trends

There has been continued tinkering with the ESVCLP and VCLP regimes in order to address technical issues with complying with the prescriptive requirements of those regimes. For example, changes have been made alleviating some of the difficulties with investing in holding companies, and eliminating the need for investees to have auditors while they are still small. The industry is currently seeking a number of other reforms as well.

In addition, as noted in question 17, where a trust carries on an active business or controls a company that carries on an active business, the trust can itself be treated as a company in some circumstances. The ATO has taken an initial view that a power to veto could amount to control for these purposes. This view has continued to evolve during the course of this year and, when finalised, could have a significant effect on the way venture capital and private equity funds participate in the governance of their investees.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

For VCLPs, ESVCLPs and MITs the number and mix of investors will be relevant for ongoing registration and eligibility requirements and needs to be notified to certain government agencies. The change of control of a financial services licensee needs to be notified to ASIC, so this would apply to fund managers.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Yes, an AFSL needs to be held on the basis described above. In addition, elections need to be made by the fund manager to obtain MIT status, and the VCLP or ESVCLP needs to be registered with the relevant federal government regulator in order to enjoy the tax benefits afforded to those vehicles.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

By issuing interests in a fund, a private equity fund is providing a designated service under Australian Anti-Money Laundering and Counter-Terrorism Financing legislation (AML/CTF) and must comply with AML/CTF as a reporting entity.

As a reporting entity, the fund is subject to the following obligations:

- enrolling with the regulator (AUSTRAC);
- conducting investor identification and verification and ongoing investor due diligence, including transaction monitoring;
- reporting suspicious matters to AUSTRAC within 24 hours or three business days, as required;
- reporting transactions greater than A$10,000 to AUSTRAC within 10 business days;
- providing compliance reports to AUSTRAC;
- implementing and complying with an AML/CTF programme that includes the designation of an AML/CTF compliance officer, systems for identifying, mitigating and managing risks, employee risk awareness training and due diligence programmes, transaction monitoring, independent review of the AML/CTF programme and investor identification and verification procedures; and

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- retaining records relating to investors and retaining each AML/CTF programme in force for a period of seven years after the record ceases to be in force.

The reporting obligations include the disclosure of the identity of the fund's investors and sponsor's members when reporting to AUSTRAC.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

While there are some examples of listed private equity fund of funds on the Australian Securities Exchange investing in PE assets through fund managers, and many listed companies and funds will have exposure to PE asset allocations, the traditional PE model in Australia has not involved listed funds. There has also been no large sponsor in this jurisdiction to give retail clients exposure to Australian PE funds.

Most Australian PE funds have wholesale or institutional clients only, and although some have a small retail client base, the run to listing has not been evident here.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

A listed fund cannot restrict the transfer of its interests; however, the Corporations Act provides restrictions on the ability of a person to acquire a relevant interest (tantamount to control of the relevant shares or units) in more than 20 per cent of the voting securities in the listed entity. The Foreign Investment Review Board may also restrict foreign persons from acquiring 20 per cent or more of certain Australian businesses meeting a range of value thresholds, including listed funds. Foreign government investors will generally also need to seek approval for any 'direct investment' (which includes most investments of 10 per cent or more, and investments below 10 per cent that have special features evidencing a strategic long-term investment).

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are some restrictions that apply, such as the size restrictions on the assets that can be acquired by a VCLP or ESVCLP, a cap on the percentage of committed capital that can be invested in an entity by a VCLP or ESVCLP, and the control issues described above in relation to trusts (see question 17), but generally a PE fund has an entitlement to invest on the same basis as any other investor. Of course, each private equity fund may itself regulate the size and nature of transactions to be undertaken on its behalf.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The ability to draw management fees and performance fees from a typical PE fund in Australia is subject only to the terms of the fund documents and the negotiations with investors, and also market practice. Separate carry trusts are also commonly used to stream carry to management.

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The main vehicles used for private equity funds in Austria are limited partnerships (LPs), typically with a corporation as the general partner, or corporations, namely limited liability companies (LLCs) and joint stock companies (JSCs). Each of the aforementioned types of entity has a separate legal personality, but partnerships are transparent for tax purposes.

Limited partnerships

Typically, investors become limited partners in an LP. The general partner is usually a limited liability company that receives a fee for assuming unlimited liability. In some structures, the general partner manages the partnership; in other structures the partnership is managed by a separate management company, which is usually an LLC. As private equity funds in most cases fall under the Alternative Investment Manager Act (AIFMG) (see question 2), the entity managing the fund must be a legal person that is licensed or registered as an alternative investment fund manager (AIFM) under the AIFMG.

Corporations

Investors become shareholders in an LLC or a JSC. A LLC is managed by a managing director, a JSC by a managing board. JSCs (as opposed to LLCs) are required by law to also have a supervisory board. Managing directors, as well as members of the managing board, have to be natural persons. However, as with LPs, corporations can outsource management functions to a management company, which in most cases needs to be licensed or registered as an alternative investment fund manager (AIFM) under the AIFMG (see above).

For investments made before 31 December 2012, LLCs and JSCs were often structured to qualify as a medium-sized business financing company (MFG) under the Corporate Income Tax Act (KStG), which still enjoys several tax benefits in relation to old investments (see question 17). Currently, there is no such preferential regime available for new investments, although in 2016 the Austrian government announced the reintroduction of the MFG as part of its 'start-up' package.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

All of the aforementioned private equity fund vehicles need to be incorporated in compliance with Austrian corporate law. Basically, this requires the adoption of the articles of association or the conclusion of a partnership agreement, the appointment of management and the submission by the founders of an application for registration of the vehicle with the Companies Register. Austrian law has minimum share capital requirements for LLCs (€35,000, or €10,000 in the case of a privileged incorporation) and JSCs (€70,000). There are generally no minimum capital requirements for newly incorporated partnerships. The incorporation process generally takes between two and four weeks.

Most private equity funds qualify as alternative investment funds (AIFs) under the AIFMG, which implemented Directive 2011/61/EU on alternative investment fund managers. An AIF is defined as a collective investment undertaking that raises capital from a number of investors to invest it in accordance with a defined investment policy for the benefit of those investors and which does not use the capital for a direct operational purpose. In addition to the corporate law requirements, the formation of an AIF requires the prior approval of the Austrian Financial Market Authority (FMA) if the fund is managed by a licensed AIFM, or the registration of the fund with the FMA if the fund is managed by a registered AIFM.

Regulation (EU) No. 345/2013 on European venture capital funds (EuVECA Regulation) was introduced to create a new pan-European designation for small AIFMs, the European Venture Capital Fund (EuVECA). Austrian-based AIFMs may register an AIF as a EuVECA provided that they comply with the EuVECA Regulation and have supplied certain information with regard to themselves and the relevant AIF to the FMA. The main advantage the AIFM gains by doing so is the option to market the relevant AIF throughout the EU under the EuVECA designation to certain categories of investors defined in the EuVECA Regulation under an EU-wide passporting regime. Passporting allows a firm authorised under an EU single market directive to market the designated fund to certain qualified investors in another EU member state, on the basis of its home state authorisation.

Regulation (EU) No. 760/2015 on European long-term investment funds (ELTIF Regulation) was introduced in November 2015 to channel capital raised through AIFs towards European long-term investments in the real economy. Austrian-based AIFM who have received approval to manage ELTIFs may register an EU-based AIF (or a compartment thereof) as an ELTIF provided that they comply with the authorisation requirements set forth in the ELTIF Regulation and submit an application to the FMA. The main advantage of such registration is the option to market the relevant AIF throughout the EU under an EU-wide passporting regime similar to the regime under the EuVECA Regulation (see above). Additionally, the designation of an AIF as an ELTIF allows its marketing to high net-worth individuals throughout the EU.

Both the EuVECA Regulation and the ELTIF Regulation are not compulsory; if an AIFM does not want to use the EuVECA or the ELTIF designation, then it does not have to comply with the EuVECA Regulation or, as the case may be, the ELTIF Regulation for a particular fund (or at all). If the AIFM chooses not to use the EuVECA or the ELTIF designation, national laws and EU regulations apply, such as national private placement regimes.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Austrian private equity fund vehicles have to be registered in the Companies Register and have to maintain a registered office in Austria. They are required by law to keep books and records. There is no requirement under Austrian law for a private equity fund vehicle to have a corporate secretary.

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As mentioned above, most private equity funds fall under the AIFMG, which requires the AIFM to appoint a custodian for each AIF it manages. Either a bank or a securities services provider with its seat in the European Union can serve as the custodian. AIFs with the investment objective of acquiring control of non-listed companies can also utilise escrow agents (usually, public notaries or attorneys-at-law) as custodians.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

As a private equity fund vehicle is typically registered with the Companies Register, certain information about the vehicle is a matter of public record. Besides general information available for all types of vehicles (such as registered office and authorised signatories), the level of information varies depending on the legal form. For LPs and LLCs (but not JSCs), the names of the investors and their shares are published in the Companies Register (note that in relation to LPs only a fixed liability amount (ie, the liability contribution) must be disclosed, which is usually entirely unrelated to the actual investment and can be as low as, for example, €1). LLCs and JSCs (but not LPs) also have to file their articles of association with the Companies Register, which can therefore be accessed by the public. As a consequence, vehicles structured as JSCs or LLCs typically have shareholder agreements (which need not be filed and thus are not public) besides the articles of association, to avoid public access to sensitive topics. Also, the annual financial statements (with varying levels of detail depending on the company type and size) have to be filed with, and can be inspected at, the Companies Register.

In addition, if the vehicle qualifies as an AIF, the AIFM is subject to the publication requirements of the AIFMG. The AIFMG requires the submission of reports by the AIFM to investors (primarily, an annual report) and regulators (primarily, an annual report and monthly list of the AIFs under management). The AIFMG also contains specific reporting obligations for (private equity) AIFs (ie, AIFs aimed at acquiring control over non-listed companies other than SMEs and real estate special purpose vehicles). For such AIFs, the manager has to report any transaction, pursuant to which the stake of the AIF in a target company reaches, exceeds or falls below 10, 20, 30, 50 or 75 per cent, to the target company, any known shareholders of the target company and the FMA.

Austrian AIFs are also listed in an informal register maintained by the FMA.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Investors in vehicles structured as LLCs and JSCs will only be liable for the portion of the share capital attributable to their respective shares (plus any additional predetermined contributions) as provided for in the articles of association). Austrian law does allow for the 'corporate veil' to be pierced only under specific circumstances (such as, actual management of the fund by an investor).

For LPs, the liability of the limited partners is limited by the 'liability contribution', as published in the Companies Register, which usually is a nominal amount and thus substantially lower than the contributed equity (see question 4). Similar to a corporation, investors in LPs will be fully liable, however, if they actually manage the LP.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Managers of Austrian private equity funds are typically general partners of an LP or fulfil their function based on management agreements with the fund vehicle. Thus, the scope of the managers' duties and the extent of their liability as regards the private equity fund are based on the provisions of the partnership agreement or, as the case may be, the management agreement.

As most private equity funds qualify as AIFs, the fiduciary duties as set forth in the AIFMG also apply, which require the manager, inter alia, to act in the best interests of the AIF, the investors in such AIF and the integrity of the market; to introduce appropriate procedures to deal with conflicts of interest; to treat the investors in an AIF fairly; and to use the required diligence in the performance of his or her duties.

Unless the private equity fund is an AIF, it is possible to limit the liability of the fund manager as regards the investors or, respectively, the fund vehicle by contractual provisions (eg, excluding the liability for 'ordinary negligence'). However, such contractual provision would still be subject to judicial review.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Austrian law differentiates between 'gross negligence' and 'ordinary negligence'. As mentioned in question 6, it is principally possible to exclude the liability of the manager for 'ordinary negligence' in the partnership agreement (if the fund vehicle is an LP) or the services agreement (if the manager acts on the basis of a services agreement), unless the fund is an AIF.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are various restrictions or issues of that type depending on the legal form of the vehicle and on whether it was set up as an AIF. By way of example, an Austrian AIF – unless qualified as a EuVECA or ELTIF (see question 2) – is only open to qualified investors. For Austrian fund vehicles, the articles of association or partnership agreement can contain restrictions on the transferability of shares or partnership interests or the expulsion of shareholders or limited partners. Also, the partnership agreement typically provides for a set procedure to remove the general partner.

Limited partnerships formed in other jurisdictions can in principle be converted into Austrian limited partnerships. Foreign private equity funds incorporated as corporations within the EU can be 'transferred' to Austria through either a cross-border merger or a migration. While the prior statements related to relocating the vehicles as such, sometimes only the place of effective management is transferred to Austria.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Austrian law does not require private equity funds to have an institutional sponsor. Provided that an institutional sponsor does not fulfil any function related to the operation of the private equity funds (such as custodian for an AIF), the bankruptcy of, or change of control in, the sponsor does not have any legal or regulatory consequences for the private equity fund. Obviously, any Austrian private equity fund associated with a certain institutional sponsor (which can be observed frequently) would face a reputational impact, if such sponsor had to file for bankruptcy.

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Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Private equity funds established as AIFs and their managers are subject to the ongoing supervision by the FMA. The FMA has a wide range of inspection and audit rights both with respect to the AIFM and the respective AIF.

Private equity funds that are not AIFs are not subject to designated ongoing regulatory supervision (except by the competent tax office). For such private equity funds, investors only benefit from the information rights set forth in the articles of association or partnership agreement of the fund vehicle and the reporting obligations under accounting and corporate law (mainly, the disclosure of the annual financial statements).

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Private equity funds established as AIFs and managed by a registered AIFM (see question 12) need to be registered with the FMA. Private equity funds established as AIFs and managed by a licensed AIFM (see question 12) need to be approved by the FMA. Special registration requirements apply to AIFs designated as EuVECAs or ELTIFs (see question 2).

Private equity funds not established as AIFs require no special registration, except for the registration with the Companies Register upon incorporation (see question 1).

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Private equity funds established as AIFs need to be managed by an AIFM. Austrian law distinguishes between AIFMs, which require licensing by the FMA, and AIFMs, which only have to register with the FMA. Licensed AIFMs do not need any additional licences for their management activities for the fund. Registered AIFMs may require a trade permit for asset managers. Special registration requirements apply for managers of ELTIFs (see question 2).

Different licensing requirements apply for the promotion of interests in the funds (see question 24).

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Austrian-based AIFMs generally require a licence from the FMA. There is a de minimis exception for managers of small AIFs with assets of less than €100 million (where leverage is used) or less than €500 million (where no leverage is used). Managers of such small AIFs are only subject to a few regulations of the AIFMG. They do not require a licence and only need to register with the FMA.

A licensed AIFM needs to have a minimum capital of €125,000, if it is an external manager of AIFs. If the AIFM is the internal manager of an AIF, the minimum capital requirement is €300,000.

In addition, the AIFM needs to have sufficient equity to cover 25 per cent of its annual running costs.

Increased equity requirements apply for licensed AIFMs, if the assets under management exceed €250 million; in any case, the minimum capital is capped at €10 million.

The persons tasked with the management of the AIFM need to be sufficiently experienced and have to pass a 'fit and proper' test by the FMA, if so requested. At least two persons must be appointed by the AIFM as its managers.

In the application, the AIFM needs to provide information on shareholders holding qualified participations in the AIFM (ie, shareholdings exceeding 10 per cent), on any closely related entities (ie, a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent), its business plan, its remuneration policy, its investment strategies, a description of any competencies delegated to third parties and information on the contractual basis pursuant to which it manages its AIFs.

The decision of the FMA regarding the licensing of an AIFM has to be passed within three months upon submission of the required documentation. If the AIFM intends to register an AIF as an ELTIF, he or she must apply to the FMA for prior approval.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such rules applying to managers or investment advisers (or their respective employees) in Austria. However, political parties are required to report any donation exceeding €50,000 to the Court of Audit, which will publish this information on its website. Additionally, Austrian political parties are barred from accepting donations over €2,500 from foreign entities or nationals. Of course, anti-bribery laws apply as well.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Austria introduced special legislation concerning the registration of lobbyists in 2012, which also requires companies utilising the services of lobbyists to register in a publicly accessible register maintained by the Federal Ministry of Justice. However, this legislation does not cover activities such as the marketing of a private equity fund.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no such rules in Austria.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

For the purposes of this question it is assumed that the fund vehicle is structured as a partnership, rather than as a corporation. Austrian partnerships are typically viewed as transparent for tax purposes, provided that the following is true:

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- the partnership's sole activity qualifies as asset management for tax purposes; and
- it is not deemed to conduct a business or commercial operation.

Any income derived by the partnership is instead allocated to its investors and taxed at their level in accordance with the rules of the tax regime applicable to the respective investor.

Domestic individual investors are taxed as follows:
- capital gains are subject to a preferred tax rate of 27.5 per cent (as of 1 January 2016); and
- dividends are subject to withholding tax at a rate of 27.5 per cent (as of 1 January 2016).

Domestic corporate investors are taxed as follows:
- capital gains are taxed at a rate of 25 per cent if they relate to an Austrian-resident portfolio company and may be tax exempt if they relate to a foreign-resident portfolio company in which a minimum shareholding of 10 per cent is (indirectly) held for an uninterrupted period of at least one year (section 10 KStG); and
- dividends are tax-exempt if they related to an Austrian-resident portfolio company or an EU-resident portfolio company and may be tax-exempt if they relate to another foreign portfolio company (section 10 KStG).

Foreign individual investors are taxed as follows:
- capital gains are only taxable (at a rate of 27.5 per cent as of 1 January 2016) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) has been at least 1 per cent during the previous five years. Note that double tax treaties usually restrict Austria's right to tax such capital gains (article 13, paragraph 5 of the OECD Model Tax Convention on Income and on Capital (MTC)); and
- dividends are subject to withholding tax at a rate of 27.5 per cent as of 1 January 2016 (subject to reduction under applicable double tax treaties).

Foreign corporate investors are taxed as follows:
- capital gains are only taxable (at a rate of 25 per cent) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) has been at least 1 per cent during the previous five years. Double tax treaties usually restrict Austria's right to tax such capital gains (article 13, paragraph 5 of the MTC); and
- dividends are subject to withholding tax at a rate of 25 per cent in the case where the exemption for foreign investors that are corporations resident in an EU member state is not applicable (but will usually be subject to reduction under applicable double tax treaties).

MFG

MFGs are tax-exempt for income from investments in participations made before 31 December 2012, meaning that the regime can no longer be used for new investments, but is still applicable to investments prior to such date. As mentioned, the tax benefits applicable to MFGs could (in full or in part) be reintroduced (see question 1).

In order to qualify as an MFG, the vehicle must have a minimum share capital of €7.3 million, with public bodies and organisations holding no more than 50 per cent of the share capital and it may not carry out any business other than investment activities and related services. In addition, an MFG is subject to certain investment restrictions, in particular the following:
- investments may not exceed €1.5 million per target and per 12-month period;
- investments have to qualify as seed, start-up or expansion capital;
- no investments can be made in businesses in distress (within the meaning of the EU guidelines on state aid for rescuing and restructuring businesses in distress) or the shipbuilding, coal and steel industries;
- the MFG has to invest 70 per cent of its funds (the remaining 30 per cent can be held as cash, bank deposits or bonds);
- investments have to be made in non-listed small and medium-sized enterprises within the meaning of Annex I to EU Regulation No. 70/2001 based in the EU or the EEA;
- the MFG can only acquire minority participations of up to 49 per cent (at least 70 per cent of the investment must be equity); and
- each participation in a target may only account for a maximum of 20 per cent of the MFG's total equity capital.

To benefit from the tax exemption, the MFG must carry out the fund activity in accordance with section 6b of the KStG for at least seven years. If not, the tax exemption is retroactively revoked. MFGs are also tax-exempt from capital duty and stamp duty triggered in connection with their establishment.

The MFG's distributions are taxed at investor level.

Domestic investors are taxed as follows:
- dividends paid to domestic private investors are generally subject to withholding tax at a rate of 27.5 per cent (as of 1 January 2016); to the extent dividends are attributable to equity investments in an MFG to a nominal value of up to €25,000 they are tax-exempt (section 27 of the Income Tax Act); and
- dividends paid to domestic corporate investors are tax-exempt, irrespective of the percentage or the duration of the shareholding (section 10 KStG).

Foreign investors are taxed as follows:
- dividends paid to foreign individual investors are generally subject to withholding tax at a rate of 27.5 per cent (as of 1 January 2016); dividends paid to foreign corporate investors are generally subject to withholding tax at a rate of 25 per cent; if the foreign investor is a corporation resident in an EU member state, dividends will usually be tax-exempt; and
- if the foreign (individual or corporate) investor is resident in a jurisdiction that has a double tax treaty with Austria, reduced tax rates usually apply.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

If the fund is structured as a limited partnership not deemed to conduct a business, non-resident investors are generally not required to file tax returns in Austria, subject to the following rules. If a capital gain is subject to taxation in Austria, the investor will be obliged to file a tax return, whereas in the case of dividends no reporting obligation is triggered. A refund, an exemption or a reduction concerning withholding taxes will also require filings with the tax authorities. Special forms provided by the Austrian tax authorities are used for the proof of residence outside Austria (and further substance requirements), which have to be submitted along with the filing with the tax authorities.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

While it is certainly desirable to obtain a ruling from the Austrian tax authorities with respect to the tax treatment of the fund vehicle, the tax authorities are, however, rather reluctant to grant such tax rulings. It should also be noted that such rulings (given that they are not governed by the new ruling regime introduced in 2011 that applies only to certain limited areas of tax law) are not binding. The taxpayer may, however, be protected by the principle of equity and good faith. Based thereon, an assessed tax shall be waived if the party has made dispositions or transactions in reliance on the tax ruling and the following is true:
- the ruling has been rendered by the competent tax authority;
- the ruling is not evidently incorrect; and
- the incorrectness of the ruling was not easily noticeable for the party.

There are no special tax rules relating to investors that are tax residents in Austria.

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20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

If the partnership is structured with no individual (but only a corporation) as general partner, as is usually the case, equity contributions had generally been subject to capital duty in the amount of 1 per cent. The same was true for fund vehicles structured as corporations. Since 1 January 2016, capital duty is no longer levied. Another area to consider is stamp duties, in particular in relation to guarantees that the formation documentation may entail. In this context it should be noted that surety agreements (including any form of assumption of a debt as joint debtor) are subject to stamp duty of 1 per cent of the secured amount provided that the surety is of an accessory nature, which means that the guarantor may avail itself not only of all defences that it personally has against the creditor, but also of all defences that the debtors of the secured debt have against the creditors. If the guarantee, however, is of an abstract nature, which means that the guarantor has to pay upon first demand and has recourse only to those defences that arise from the guarantee itself, then such transaction is not subject to stamp duty. Therefore, guarantee wordings explicitly stating that a specific guarantee is meant to be abstract are commonly used.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

'Carried interest', which is defined as a compensation of a partner of an asset management partnership received because of outstanding contributions to a successful management of the investments, is included in the investment income according to the Department of International Taxation of the Austrian Ministry of Finance (EAS 3280 as of 14 May 2012; EAS 2698 as of 6 February 2006 and BMF 15 December 2008 [BMF 010221/3364-IV/4/2008]). Income qualifying as investment income received by an individual who is subject to unlimited taxation in Austria is taxable at the special tax rate of 27.5 per cent (as of 1 January 2016). Despite this administrative guideline, a case-by-case analysis is recommended, as the line between (self-) employed income and investment income is a rather unclear one.

The management fees received by a partner of an asset management partnership are not subject to VAT. According to the Austrian tax authorities, the general partner of a partnership is not an entrepreneur; his or her services are supplied in the exercise of a corporate function and not as a result of an exchange of services. If the fund vehicle is a corporation, however, the fees of a managing shareholder will usually be subject to VAT, unless the manager is employed by the corporation.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Austria has entered into approximately 90 tax treaties (as of January 2017). According to the established practice of the Austrian tax authorities, a fund vehicle structured as a tax-transparent partnership is generally not entitled to treaty benefits. Rather, the investors themselves may rely on the tax treaty directly. If the fund vehicle is structured as a corporation, tax treaties will generally apply to the corporate fund vehicle itself.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

There are no other significant tax issues relating to private equity funds. However, there is a special tax regime for investment funds in Austria. A private equity fund should normally not be subject to this regime.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Offers and sales of interests in private equity funds formed in Austria are subject to the following selling restrictions, which depend on the category of the private equity fund:

- AIFs managed by a licensed AIFM:
  - interests in the fund may only be offered or sold after the AIF is approved by the FMA; and
  - interests in the fund may be offered or sold to private investors, if the prerequisites of sections 48 and 49 AIFMG are met, except if the fund is registered as follows:
    - as an EuVECA: in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor); or
    - as an ELTIF: in this case, it may be offered to private investors subject to certain restrictions (in particular, an offer is only possible to private investors having an investment portfolio of at least €100,000 after such investor has received appropriate investment advice);
- AIFs managed by a registered AIFM:
  - interests in the fund may only be offered after the AIF is notified to the FMA; and
  - interests in the fund may not be offered or sold to private investors, except if the fund is registered as an EuVECA; in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor); and
- private equity funds outside of the AIFMG:
  - any public offer of interests in private equity funds outside of the AIFMG requires the publication or approval of a prospectus by the FMA, or both, unless a private placement exemption applies;
  - the private placement exemption applies, in particular, for the following:
    - offers to qualified investors only;
    - offers with a minimum investment amount of €100,000; and
    - offers to less than 150 investors; and
    - even if the private placement exemption applies, the intended offer has to be notified to the issue register, maintained by the Austrian Control Bank.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Save as set out in question 24, there are no additional restrictions on the types of investors that may participate in private equity funds.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

For fund vehicles established as LPs or LLCs, any change in the shareholders has to be notified to the Companies Register. No such requirement exists with respect to JSCs, provided that there is more than

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one shareholder. Starting on 1 June 2018, Austrian fund vehicles are required to maintain a list of their beneficial owners (ie, natural persons holding or controlling more than 25 per cent of the fund vehicle) and have to submit the list of beneficial owners (including subsequent changes) to the Austrian Statistical Agency.

Licensed AIFMs are required to report any changes to their legal status of the time when their licence was granted, in particular any changes in the management or any change in qualified owners (ie, owners holding more than 10 per cent of the capital or voting rights in the AIFM).

Otherwise, there are no special requirements only applicable to private equity funds as regards the notification of the identity of investors or the composition of ownership.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

There are licence requirements for persons offering interests in an Austrian private equity fund. The actual licence required depends on the legal category of the private equity fund. Different licences are required depending on whether the private equity fund is an open-ended AIF, a closed-ended AIF or a non-AIF private equity fund.

Open-ended AIFs can be offered by banks, securities firms or securities services firms.

Closed-ended AIFs (as well as non-AIF private equity funds) can be offered by banks, securities firms or persons or entities with a trade permit for asset managers.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The provisions of the newly introduced Financial Market Anti-Money Laundering Act, which implemented the provisions of the fourth EU Anti-Money Laundering Directive, also apply to AIFMs. Consequently, AIFMs have to comply with enhanced customer due diligence requirements (on a risk-based approach) to identify the investors (and their beneficial owners) in the fund.

For managers of private equity funds that are not AIFs, no specific money laundering rules exist, unless the managers themselves are registered as, for example, securities services providers, in which case they also are subject to the Financial Market Anti-Money Laundering Act.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Only shares of a JSC (but not equity interests in an LLC and an LP) can be listed on a regulated market of the Vienna Stock Exchange. In our experience, it is not customary to list private equity funds in Austria.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As mentioned in question 29, a listing of a private equity fund is not common in Austria. Transfer restrictions of shares of a JSC can – and typically are – only included in connection with rights offerings.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Restrictions primarily apply to private equity funds established as MFGs (see question 1). Also, private-equity funds established as an AIF will typically be subject to the post-investment restrictions of section 28 AIFMG for a period of 24 months following the acquisition of control of a (listed or unlisted) target. Also, certain investment restrictions apply to AIFs designated as ELTIFs.

There are no other restrictions specific to private equity funds.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

If the sponsor has an equity interest in the fund, any compensation or profit sharing arrangement would have to be on an arm's-length basis. Otherwise such compensation or profit sharing arrangement would be deemed to violate the prohibition of the return of equity, and is at risk of being declared null and void.

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Brazil

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The most commonly used vehicle for private equity investments is the private equity investment fund (FIP or Fund), which requires active participation and influence in the administration and decision-making process of the invested companies.

The FIP does not have a separate legal personality: it is classified as a co-ownership, hence it is understood as a pool of assets owned by the quotaholders. This means that the FIP, aside from having its own accountability, procedural capacity and equity, is not considered to have a separate legal personality and must be represented by its administrator.

As set out in current Brazilian regulations and also as a consequence of the fact that the FIP does not have a legal personality of its own, the quotaholders may be held liable in the case of loss.

Despite the above considerations, adverse consequences for investors have been highly uncommon so far. The administrator, along with other service providers as applicable, is held liable for most of the legal consequences in relation to compliance with legal requirements and fiduciary duties.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The process of constituting a FIP usually takes around 10 days to be concluded as from the delivery of the necessary documents to the Brazilian Securities Commission (CVM), if no additional requirements, documents or clarifications are demanded.

The most important agent involved in the incorporation of a FIP is the administrator, who must necessarily be a legal person duly licensed by the CVM to exercise the activity and to perform portfolio management services. Other agents may or may not be involved in the Fund's further activities as service providers. Despite the fact that hiring these agents is not mandatory under the regulations, it is not common to deal with FIPs that do not count at least one portfolio manager, whose main task is to decide on the management of the FIP's portfolio, taking investment decisions.

The FIP's by-laws shall be registered before a notary. The registered by-laws, the tax number and the name of an independent auditor shall be filed with the CVM and all the information regarding the quota offering. The CVM shall automatically grant the register within 10 days if no clarifications or additional information are needed. The current FIP regulations do not demand any minimum capital, which results in this being defined in the fund's by-laws.

The CVM charges essentially two fees: one on a quarterly basis, the supervisory fee, which is fixed taking into consideration the range of the average net equity and can vary from 939.81 to 16,916.56 reais, and one over each public quota distribution by the FIP, of 0.64 per cent of the total distribution amount.

The Fund, as well as its administrator and manager, may optionally follow the Brazilian Association of Financial and Capital Market Entities (Anbima) Regulations and Best Practices Codes (the Codes). The Anbima is a self-regulating agency of the Brazilian capital market whose Codes submit its adherents to its supervision. Once institutions adhere to the appropriate Codes, the Anbima grants it a seal that may be announced, for example, on the sponsors' websites. Since the Codes and the Anbima's actions are fairly strict when it comes to governance and ethics within financial institutions, the seal tends to increase investors' trust in the vehicle.

The adherence to the Codes costs 1,182 reais. The cost of registering the first quota issuance by an FIP depends on the ranges of the offering value and may vary from 1,388 to 14,576 reais. Registering all other public offers costs 0.003887 per cent of the offer's value with a minimum cost of 13,881 reais and maximum of 97,168 reais.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A FIP must be administered by a legal person duly registered and authorised by the CVM to manage portfolios. There are some service providers that may or may not be demanded by the FIP and hired by the administrator, such as custodians, portfolio managers and consultants.

The FIP is not required to have a registered office, which in practice means that its headquarters and all back-office activities are attributed to the administrator. It is, however, required to have its own books and records, such as the minutes book of quotaholders' meetings and the registry book of nominative quotas. The administrator is responsible for keeping all the information in the books up to date.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The identities of investors and the amount of their capital commitments are not publicly disclosed. The CVM website allows free access to the following Fund documents:

- by-laws;
- reference forms;
- trial balances;
- composition of the portfolio;
- daily data, such as net worth value and number of quotaholders;
- prospects;
- Fund's fact sheet;
- financial statements; and
- monthly profile.

In addition, the minutes of quotaholders' meetings, except for their identities, are usually published on the administrator's or manager's websites. The FIP is also required to publish material facts whenever they occur.

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Some of these documents must be periodically updated and submitted to the CVM, such as daily and monthly data, financial statements, which must be presented annually together with the independent auditor's report, and the reference form, and are commonly referred to as periodical obligations. The consequences of non-compliance with these obligations may lead to a daily fine of up to 500 reais imposed on the administrator, who is responsible for keeping the documents up to date.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Investors may be held liable for the FIP's losses in the case of negative net worth, in which case the investors, aside from losing all the capital invested, would also be required to deploy capital in order to cover losses.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Fiduciary duties are established for the FIP's administrator and are extended to the manager, none of which may be modified. The administrator is fully responsible for compliance with fiduciary duties, as well as jointly with the manager for the latter's fiduciary duties.

Fiduciary duties are that both the administrator and the manager exercise their activities aiming at achieving the best conditions for the FIP, employing the care and diligence that an active person of integrity normally employs when running his or her own businesses, acting with loyalty when it comes to the quotaholders' interests and avoiding all practices that may jeopardise the fiduciary relationship established between them. Also, both the administrator and the manager must exercise or ensure the exercising of all rights resulting from the FIP's net worth and activities, aside from what may be disposed within the complementary information form about policies regarding the FIP's voting rights, and actively defend the quotaholders' rights with the diligence demanded by each circumstance, always adopting every measure to ensure that such rights are to be effectively used.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The FIP's administrator is responsible for every breach of fiduciary duty and non-compliance with existing regulatory obligations under Brazilian law. There is no distinction in applicable laws and regulations between gross or ordinary negligence when it comes to the administrator's liability, as well as the liability of all service providers that may exist under the FIP's structure.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

FIPs are closed-ended funds. This means that their quotas cannot not be withdrawn until the fund is liquidated. The amortisation of quotas is permitted if approved by the quotaholders' meetings or by the manager.

A FIP is registered before the CVM and shall be classified within one of the following categories, according to the composition of its portfolio:
- multi-strategy;
- seed capital;
- emerging companies;
- infrastructure; and
- intensive economic productions in research, development and innovation.

Fitting within each of these structures is undertaken according to the following criteria:
- annual gross revenues of the target companies;
- the FIP's portfolio composition; and
- will to influence the decision-making processes of the invested companies.

The type of FIP that best fits the objectives of the administrator must be reflected in its category.

In general, the FIP must keep at least 90 per cent of its net worth invested in the following portfolio assets as established by existing regulation, which may change according to the category:
- shares;
- subscription bonuses;
- simple, non-convertible debentures; and
- other securities convertible into shares, either issued by private or public Brazilian companies, as well as limited liability companies.

In general and with certain exceptions, FIPs are allowed to invest up to 33 per cent of their resources in non-convertible debentures.

Multi-strategy FIPs are restricted to professional investors, as detailed in question 25, and may invest up to 100 per cent of their resources in foreign assets (see question 31).

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Generally, a company under liquidation and bankruptcy proceedings (except for Chapter 11-like restructuring proceedings) shall not continue with its regular activities. Although there is no regulatory provision for such cases, it should be reasonably interpreted that a quotaholders' meeting should be convened to change or terminate the administrator under a liquidation or bankruptcy proceeding.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The principal regulatory body that would have authority over a private equity fund and its manager is the CVM. As mentioned above, there is also a self-regulatory body called the Anbima, which only has jurisdiction over its members.

The CVM has broad audit and inspection rights over its supervised entities. Investment managers must be previously licensed by the CVM. Also, such entities have continuing filing and disclosure obligations with the CVM, such as annually filing a form of reference which must be continuously updated), filing codes of conduct, compliance manuals and money laundering prevention mechanisms, among others.

Funds also have several reporting obligations (see question 8).

All such reporting information must be made available at the managers' and the CVM's websites.

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11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

There are no additional requirements other than those listed in question 2.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Yes. The portfolio manager must be registered with the CVM and, in order to do so, it must assign at least one director to lead on the activity of portfolio management. This director must also be registered with the CVM.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The FIP manager, as well as any other fund manager, must be duly registered with the CVM and, as such, must comply with the requirements set by the regulatory entity. The requirements vary as applied to individuals or legal entities, are listed by current Brazilian laws and may be summarised as follows.

The individual manager must, aside from being able to dispose of his or her own goods:

- have a residence in Brazil;
- have a higher degree qualification, either from Brazil or elsewhere;
- take a certification exam, which must have had its methodology and content previously approved by the CVM – this exam is nowadays set and applied by certain certified institutions, such as the Anbima and the charted financial analyst organisation;
- have an immaculate reputation;
- not be prevented or suspended from exercising an administrative position at financial institutions or other entities regulated by the CVM, the Central Bank of Brazil (BACEN), the Private Insurance Agency or the National Private Pension Agency;
- not have convictions for bankruptcy, corruption, money laundering or other related crimes; and
- not be prevented from managing his or her own assets as a result of an administrative or judicial decision.

The legal entity that wishes to provide these services must comply with the following:

- have its headquarters in Brazil;
- include in its corporate aims the administration and management of securities portfolios;
- assign the activity of management of securities portfolios to one or more statutory directors, who must also be authorised by the CVM to do so under the criteria listed above; and
- assign compliance activities to a statutory director.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no specific rules, laws or other regulatory mechanisms regarding political contributions by FIPs, whether about disclosure or limitations of any kind. However, since 2015, pursuant to a Brazilian Supreme Court decision, no kinds of political financing by legal entities are allowed – only individuals, and up to the limit of 10 per cent of their annual net revenues, can contribute to parties, candidates or their campaigns.

Even though an FIP, as stated in question 1, is not recognised as a legal entity owing to its lack of legal personality, it could be fairly reasonable to assume that the prohibition would be extendable to any investment funds.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no specific rules, policies or regulations that restrict or require disclosure by an FIP in the marketing of the fund to public pension plans and other governmental entities.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks when it comes to investing in FIPs. However, a federal law dating from 1964 establishes the written authorisation of BACEN as a requisite for any private banks to participate in companies in general.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

FIPs are generally exempted from tax on capital gains and income distributions. However, according to a new provisional legal act (MP 806) yet to be ratified by the Brazilian Congress, they may be taxed in the future if certain conditions are met.

With respect to distributions to quotaholders, generally the administrator must withhold a 15 per cent income tax on the distributions that exceed the capital invested.

For quotaholders not resident in Brazil, the law provides for an exemption (see question 18).

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Income distributions and capital gains to non-resident investors are subject to income tax at zero rate, as long as no individual quotaholder owns more than 40 per cent of the Fund's quotas or any number of quotas that assure this quotaholder more than 40 per cent of the FIP's distributions. If this percentage is exceeded, the foreign investor shall be taxed under the rules in question 17.

All non-resident investors must obtain a federal taxpayer identification number in order to invest in the financial and capital markets in Brazil, as well as assign a local representative to fulfil tax obligations from such investments.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

No ruling from Brazilian tax authorities is necessary for the tax treatment of FIPs in Brazil. All FIPs constituted within the country are subject to the same ground rules, aside from the exemptions listed in questions 8, 18 and 31.

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Update and trends

In October 2017 a provisional legal act, MP 806, modified the entire taxation mechanism applied to FIPs and established substantial differences regarding the tax treatment of such vehicles. The act is still subject to ratification by Congress (see question 17).

In addition, recent federal police investigations exposed corruption schemes related to pension funds, which led to a handful of failed investments in the capital market and affected investors' trust in the system. These investigations have had a negative impact on new local fundraising efforts, as well as private equity investments by pension funds.

However, Brazil has experienced a steep decrease in interest rates, which is expected to attract investors to more risky assets, such as private equity. This might also lead to a rise in competition for investments, which may increase the companies' valuation.

It is also important to mention that 2018 is a presidential election year in Brazil with unpredictable outcomes. In this situation, it is reasonable to expect that relevant investment decisions will be postponed until a more predictable scenario presents itself.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

Aside from the fees listed in question 1, no other significant organisational taxes are due.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Investment managers are subject to regular enterprise income (IR/CSL), revenues (PIS/COFINS) and service taxes (ISS).

The law provides for exemptions for local service providers (such as investment managers) who provide services to non-resident entities (such as foreign private equity funds).

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Brazil is a party to many treaties to avoid double taxation, none of which, in principle, provides for a more favourable taxation framework than the national treatments themselves.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

There are no other significant tax issues relating to FIPs in Brazil.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

The public distribution of quotas generally needs to be registered with the CVM.

However, usually FIP quotas are distributed through public offers with restrictions, in accordance with CVM Instruction 476/09. Such distributions are exempt from registration with the CVM.

Such distributions are subject to the following restrictions:

- restricted to professional investors;
- no more than 75 potential investors may be contacted; and
- no more than 50 investors may acquire quotas.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Not every person is allowed to invest in an FIP. Investments are restricted to qualified or professional investors, which are defined as follows.

Professional investors

- Financial institutions and all other entities existing under BACEN regulation;
- insurance companies and capitalisation companies;
- closed and open supplementary pensions entities;
- individuals or legal entities whose financial investments add up to over 10 million reais and, additionally, state their professional investor status in a specific declaration;
- investment funds;
- investment clubs, as long as their portfolios are managed by duly registered managers with the CVM;
- autonomous investment agents, portfolio managers, analysts and investment advisers duly registered with the CVM, when it comes to their own finances; and
- non-resident investors.

Qualified investors

- Professional investors;
- individuals or legal entities whose financial investments add up to 1 million reais and, additionally, who state their qualified investor status in a specific declaration;
- individuals who took certification exams or are otherwise approved by the CVM under the requirement to register as independent investment agents, portfolio managers, analysts and investment advisers, when it comes to their own finances; and
- investment clubs, as long as their portfolios are managed by one or more quotaholders understood as qualified investors.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The identity of funds investors is generally protected by bank secrecy laws and must not be disclosed unless certain conditions are met.

However, for the purposes of applicable anti-money laundering laws, securities transactions above a specific threshold must be communicated to the Financial Activities Control Board of the Ministry of Finance.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Intermediaries selling interests in private equity funds must be registered with the CVM as intermediaries.

Investment managers may distribute quotas of FIPs managed by them, if certain specific legal requirements are observed.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Money laundering is a felony under current Brazilian laws and is punishable with penalties from fine-paying to imprisonment. Aside from

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these consequences, participants in the financial and capital markets proven to have committed these offences may lose their licences.

Current regulations demand that administrators and portfolio managers, as well as financial institutions in general, elaborate, publish online and implement internal rules that allow them to identify their customers, the origin of resources that they intend to apply and to constantly track their profiles as a way to reduce money laundering schemes involving financial and capital markets.

BACEN demands that all information regarding investors and transactions conducted by financial institutions remain stored for a minimum period of five years as from the closing of the account or last transaction performed or demanded by the investor. Such information must remain available to the authorities for audit.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

FIPs are able to list on a securities exchange as far as they are regularly constituted with the CVM.

One of the greatest advantages is that FIPs are closed-ended funds and, as such, the negotiation of their quotas on the securities exchange market makes it easier for quotaholders to increase liquidity options for their investments as an alternative to withdrawal or waiting for amortisation. The main disadvantage regards the expenses that come with listing the FIP quotas on organised markets, since more registers and licences are needed, and for every public offer the supervisory fees itemised in question 2 become due.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Listed FIPs may restrict transfers to qualified investors only.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Current regulations impose concentration limits to the portfolio's composition, which may vary among the types of FIPs listed in question 8. Aside from the exceptions, FIPs may invest in shares, subscription bonuses, non-convertible debentures, other securities convertible or exchangeable into shares of listed or non-listed companies, as well as equity interests of limited liability companies. The FIP may invest up to 33 per cent of its net equity in one type of financial asset.

FIPs may invest up to 20 per cent of their net equity in assets located abroad, as long as such assets are economically equivalent to those listed above. A foreign investment is defined according to its issuer's headquarters, as long as the issuer does not have 90 per cent or more of its net equity in national assets, or the issuer, despite having headquarters in the country, has 50 per cent or more of its net equity in assets abroad. In the case of a FIP whose by-laws allow investing in foreign assets, as long as it is solely available to professional investors and includes 'foreign Investments' in its official denomination, it may invest up to 100 per cent of its net equity in such assets.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Usually, the investment manager's compensation is established as management and performance fees.

Management fees are usually established as a percentage of the Fund's net worth. Performance fees in local funds are usually set as a percentage of the fund's profits on the capital invested plus a hurdle rate, which is usually an inflation-indexed rate plus a fixed rate.

Management and performance fees are provided for in the Fund's by-laws, treated as services rendered and taxed as such.

Transaction fees charged by the investment manager or related companies should be approved by the quotaholders' meeting, since the regulations require such approval in case of conflicts of interest. Many FIPs' by-laws forbid the payment of transaction fees in such cases.

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Cayman Islands

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

An exempted limited partnership (ELP) established under the Cayman Islands Exempted Limited Partnership Law 2014 (the ELP Law) is the most commonly used structure in the Cayman Islands for forming private equity funds (PE funds). An ELP does not have a separate legal personality. An ELP must consist of the following:

- one or more persons called general partners who shall, in the event that the assets of the ELP are inadequate, be liable for all debts and obligations of the ELP; and
- one or more persons called limited partners who shall not be liable for the debts and obligations of the ELP except as provided in the partnership agreement and to the extent specified in the ELP Law.

Investors in an ELP are issued partnership interests and join the ELP as limited partners. Generally speaking, a limited partner's liability in an ELP is limited to the extent of the limited partner's partnership interests (but this limited liability status can be lost in instances where the limited partner takes part in the conduct of the business of the ELP). The general partner of the ELP is responsible for the management and conduct of the business of the ELP.

The general partner of a PE fund is usually a company or another ELP established specifically as part of the overall PE fund structure. At least one general partner of the ELP must, if a company, be registered (either as a foreign company or a Cayman Islands incorporated company) under the Companies Law (2016 Revision) of the Cayman Islands (the Companies Law) or, if a partnership, be registered (either as a foreign partnership or an ELP) under the ELP Law.

A PE fund can also be established as a company using a Cayman Islands exempted company incorporated with limited liability, which has a separate legal personality distinct from its shareholders. The exempted company is established with share capital and shares are issued to investors in consideration of investment proceeds. Each investor's or shareholder's liability is limited to the amounts unpaid on its shares, if any, or to such amount as the shareholders may respectively undertake by the memorandum of association to contribute to the assets of the company in the event of it being wound up.

A PE fund can also be established as a limited liability company using a Cayman Islands limited liability company (LLC). The LLC is designed to be substantially similar to the form of a Delaware limited liability company and has a separate legal personality, distinct from its members. The LLC is established without a share capital and otherwise resembles an ELP in having its members' liability limited by reference to the amounts of capital they have agreed to contribute or as otherwise stated in the operating agreement of the LLC (the LLC agreement).

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

Being a partnership, the ELP is established first by both the general partner and an initial limited partner (eg, a principal of the PE fund manager) entering into an initial limited partnership agreement. Second, by a section 9 registration statement (section 9 Statement) being filed with the Cayman Islands Registrar of Exempted Limited Partnerships (the Registrar) signed by the general partner of the ELP and including the following details:

- the name of the ELP;
- the general nature of the business of the ELP;
- the address of the ELP's registered office in the Cayman Islands (legally required to be in the Cayman Islands);
- the term, if any, for which the ELP is entered into or, if for unlimited duration, a statement to that effect and the date of its commencement;
- the name and address of each general partner; and
- a declaration that the ELP will not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that ELP exterior to the Cayman Islands.

There are certain supporting documents that must also be filed in respect of the general partner (for example, in the case of a corporate general partner, Certificate of Incorporation and Certificate of Good Standing).

Upon paying the requisite fee and filing the completed registration documents, the Registrar will issue a Certificate of Registration, which is conclusive evidence that compliance has been made with all the requirements of the ELP Law in respect of formation and registration of the ELP.

A Cayman Islands exempted company is established by completing the following:

- filing an affidavit of the subscriber to its memorandum of association;
- filing its memorandum of association and articles of association with the Cayman Islands Registrar of Companies; and
- payment of the requisite filing fees.

An LLC is established by filing a registration statement (Registration Statement) with the Cayman Islands Registrar of Limited Liability Companies (the LLC Registrar) signed by or on behalf of any person forming the limited liability company and including the following details:

- the name of the LLC;
- the address of the LLC's registered office in the Cayman Islands (legally required to be in the Cayman Islands);
- the term, if any, for which the LLC is formed or, if for unlimited duration, a statement to that effect; and
- a declaration that the LLC will not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that LLC exterior to the Cayman Islands.

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The timescale and costs depend on the nature and complexity of the transaction. However, the registration of an ELP or LLC or the incorporation of an exempted company can be done on an express basis within 24 hours. Cayman Islands legal counsel will be able to provide an estimate of legal fees and disbursement costs once they have conducted an overview of the overall PE fund structure. The registration fee payable to the Registrar for an ELP is currently approximately US$1,220. An ELP will be required to file with the Registrar a return on or before 31 January in every year and pay the Registrar a fee, currently approximately US$2,500.

For an exempted company the registration fee will depend on the level of the authorised share capital of the company. An exempted company that falls within the lowest possible band of authorised share capital will have to pay a current incorporation fee of approximately US$732. Similarly, an exempted company must file an annual return in January of each year and pay a fee to the Registrar of Companies, currently approximately US$854 for the lowest band of authorised share capital.

For an LLC, the registration fee payable to the Registrar is currently approximately US$976. An LLC will be required to file with the Registrar a return on or before 31 January in every year and pay the LLC Registrar a fee, currently approximately US$976. At the formation stage for a PE fund the only service providers that it is necessary to engage are a Cayman Islands legal counsel and a registered office service provider. Most law firms have an affiliated management company that can provide registered office services.

There are no material minimum capital requirements prescribed by Cayman Islands law.

As further discussed in question 10, if the equity interests of the PE fund are redeemable at the option of the investor it may be required to be registered as a 'mutual fund' pursuant to the Cayman Islands Mutual Funds Law (2015 Revision).

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

There is no requirement under Cayman Islands law for a PE fund (whether structured as an ELP, an exempted company or an LLC) to have a Cayman Islands-based custodian or administrator.

The ELP is required to maintain a registered office in the Cayman Islands.

The general partner of the ELP is responsible for maintaining (or causing to be maintained) a register of security interests granted with respect to a partnership interest or part thereof indicating, among other things, the identity of the grantor and grantee, the partnership interest subject to the security interest and the date notice of the interest was served on the ELP.

The general partner is responsible for maintaining (or causing to be maintained) in the country or territory that the general partner may determine (including outside the Cayman Islands) a register of limited partners which shall contain the name and address of each person who is a limited partner of the ELP, the date on which a person became a limited partner and the date on which a person ceased to be a limited partner, and the register shall be updated within 21 days of the date of any change in the particulars therein. The general partner shall also be responsible for maintaining (or causing to be maintained) at the registered office of the ELP a record of the address at which the register of limited partners is kept.

The general partner is also required to maintain (or cause to be maintained) in any country or territory that the general partner may determine, a record of the amount and date of the capital contributions of each limited partner and the amount and date of any payment representing a return of the whole or any part of the capital contribution of any limited partner; such record shall also be updated within 21 days of the date of any change in the particulars therein.

An exempted company is also required to maintain a registered office in the Cayman Islands, a register of mortgages and charges, a register of directors and officers and a register of members. The latter need not be maintained locally in the Cayman Islands.

An LLC is also required to maintain a registered office in the Cayman Islands, a register of mortgages and charges, register of security interests, a register of managers and a register of members (together with a record of contributions and distributions). The register of members and record of contributions need not be maintained locally in the Cayman Islands.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The register of limited partners (and address of where it is maintained) of an ELP is not open to public inspection, but instead is required to be open for inspection during all usual business hours by all partners or by any other person with the consent of the general partner. The record of contributions is only open to inspection by a person with the consent of the general partner. A copy of the section 9 Statement and any amendments made to it is publicly available for inspection upon payment of a fee to the Registrar.

Under the Companies Law, the register of members and the register of directors of an exempted company are not open to public inspection and are private documents. However, shareholders of the exempted company are entitled to see their own details in the register of members. An exempted company is required to keep at its registered office a register of mortgages and charges specifically affecting property of the exempted company. The register of mortgages and charges is required to be open to inspection by any creditor or member of the exempted company at all reasonable times. The only publicly available information in respect of an exempted company is its name, company number, date of incorporation, registered office, the type of company (eg, exempted, special economic zone, segregated portfolio company) and whether the company is active or has been dissolved or is inactive, which can be accessed via the website of the General Registry of the Cayman Islands.

Under the Limited Liability Companies Law 2016 (the LLC Law), the register of members and the register of managers of an LLC are not open to public inspection and are private documents. However, those persons expressly given a right to inspect the LLC agreement or otherwise as permitted by the manager of the LLC, will have the ability to inspect the register of members. Unless otherwise provided in the LLC agreement, each member has the right to inspect from time to time true and full information regarding the state of the business and financial condition of the LLC. An LLC is required to keep at its registered office a register of mortgages and charges specifically affecting property of the LLC. The register of mortgages and charges is required to be open to inspection by any creditor or member of the LLC at all reasonable times. The only publicly available information in respect of an LLC is its name, registration number, date of registration, registered office and whether the LLC is active or has been struck-off. This information can be accessed via the website of the General Registry of the Cayman Islands.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

As mentioned in question 1, the limited liability of the limited partners of an ELP (who would be the third-party investors in a PE fund) may be lost if the relevant limited partner takes part in the management or operation of the ELP. The following is a non-exhaustive list of activities that a limited partner can undertake without risking loss of its limited liability status:

- holding an office or interest in, or having a contractual relationship with, a general partner of the ELP, or being a contractor for or an agent or employee of the ELP or of a general partner of the ELP or acting as a director, officer or shareholder of a corporate general partner;
- consulting with and advising a general partner or consenting or withholding consent to any action proposed, in the manner contemplated by the partnership agreement, with respect to the business of the ELP;

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- investigating, reviewing, approving or being advised as to the accounts or business affairs of the ELP or exercising any right conferred by the ELP Law;
- acting as surety or guarantor for the ELP either generally or in respect of specific obligations;
- approving or disapproving an amendment to the partnership agreement;
- calling, requesting, attending or participating in any meeting of the partners of the ELP;
- taking any action that results in the winding up or the dissolution of the ELP;
- taking any action required or permitted in the partnership agreement or by law to bring, pursue, settle or terminate any action or proceedings brought in circumstances where the general partner(s) has authority to do so but refuse, without good cause, to institute such proceedings;
- appointing a person to serve on a board or committee of the ELP, a general partner or a limited partner or removing such person;
- serving on any board or committee of the exempted limited partnership, a general partner, the limited partners or the partners, or by appointing, electing or otherwise participating in the choice of a representative or any other person to serve on any board or committee, or by acting as a member of any board or committee either directly or by or through any representative or other person, including giving advice or consenting, or refusing to consent, to any action proposed by the general partner on behalf of the ELP and exercising any powers or authorities or performing any obligations as a member of that board or committee in the manner contemplated by the partnership agreement;
- serving on the board of directors or a committee of, consulting with or advising or being an officer, director, shareholder, partner, member, manager, trustee, agent or employee of, or by being a fiduciary or contractor for, any person in which the ELP has an interest or any person providing management, consultation, custody or other services or other products for, to or on behalf of, or otherwise having a business or other relationship with, the ELP or a general partner of the ELP; and
- voting as a limited partner on certain matters in relation to the ELP, for example its dissolution and winding up; the purchase, sale or transfer of assets; the incurrence or renewal of indebtedness; change in the nature of business; the admission, removal or withdrawal of a general or limited partner; or transactions in which one or more general partners have an actual or potential conflict of interest with one or more limited partners.

If a limited partner loses its limited liability status, it will be liable in the event of the insolvency of the ELP for all debts and obligations of the ELP incurred during the period that the limited partner participated in the conduct of the business of the ELP as though the limited partner was, for such period, a general partner of the ELP, provided that the limited partner shall be rendered liable only to a person who transacts business with the ELP during such period with actual knowledge of such participation and who then reasonably believed the relevant limited partner to be a general partner of the ELP.

In addition, if a limited partner receives a payment representing a return of any part of his or her contribution or is released from any outstanding obligation in respect of his or her commitment and at the time that the payment was made or the release effected the ELP is insolvent including where the payment or release causes the insolvency or the limited partner has actual knowledge of the insolvency of the exempted limited partnership, then for a period of six months commencing on the date of that payment or release but not thereafter, the limited partner shall be liable to the ELP for the amount of the payment or the due performance of the released obligation in respect of his or her commitment in each case to the extent that the repayment or performance of the released obligation is necessary to discharge a debt or obligation of the ELP incurred during the period that the contribution or commitment represented an asset of the ELP.

Unlike the ELP, an exempted company is regarded as having separate legal personality, and being an entity distinct from its shareholders. The limited liability status of shareholders of an exempted company will generally be respected. Similarly to a number of other jurisdictions, including under English law, there may be certain circumstances where a Cayman Islands court might disregard the fundamental principle that a company is a separate legal person from its shareholders and that their respective assets and liabilities are distinct. Such unusual circumstances may include where the company is considered by the courts to be used as a tool for fraud or other criminality or when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he or she deliberately evades or whose enforcement he or she deliberately frustrates by interposing a company under his or her control.

An LLC is also regarded as having separate legal personality, and being an entity distinct from its members. The limited liability status of members of an LLC will generally be respected. Similarly to a number of other jurisdictions, including under English law, there may be certain circumstances where a Cayman Islands court might disregard the fundamental principle that an LLC is a separate legal person from its members and that their respective assets and liabilities are distinct, although this has never been tested in relation to an LLC. Such unusual circumstances may include where the LLC is considered by the courts to be used as a tool for fraud or other criminality or when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he or she deliberately evades or whose enforcement he or she deliberately frustrates by interposing an LLC under his or her control.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The general partner of the ELP is responsible under the ELP Law for the management of an ELP. In the context of a PE fund, a substantial part of this responsibility is delegated pursuant to the terms of an investment management agreement to the PE fund's investment manager. It is usually the general partner (unless otherwise delegated) that enters into contracts, deeds, instruments or other documents on behalf of the ELP. In conducting the business of the ELP, the general partner has a fiduciary duty under section 19(1) of the ELP Law to act at all times in good faith and, subject to the express terms of the partnership agreement to the contrary, in the interests of the ELP. The duty to act in the interests of the ELP can therefore be modified by the terms of the partnership agreement provided always that the general partner acts in good faith. Even where the general partner has delegated certain of its responsibilities to the PE fund's investment manager, it remains subject to this duty and therefore must retain supervisory oversight of the responsibilities delegated to the PE fund's investment manager.

The duties owed by the PE fund's investment manager will be set out in the investment management agreement between the investment manager and the ELP and may be modified in the manner set forth in the investment management agreement.

In the context of a PE fund that is structured as an exempted company, the management of the entity is vested in the directors. The duties and liabilities of directors of such company will be governed by the Companies Law as supplemented by Cayman Islands case law and English common law insofar as English common law has not been amended by statutory provisions in the Cayman Islands. English case law is considered as persuasive in the courts of the Cayman Islands to the extent that there is no Cayman Islands case law to the contrary. A substantial proportion of the duties and responsibilities of directors of the PE fund (structured as an exempted company) are normally delegated to the investment manager of the PE fund under the terms of the investment management agreement.

Directors of an exempted company owe a number of fiduciary duties to the company. The fiduciary duties include the following:

- the duty to act in accordance with the constitution of the company (that is, the memorandum of association and articles of association);
- the duty to act in good faith in the best interests of the company; and
- the duty to act for a proper purpose.

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The directors of an exempted company are also subject to the common law duty to undertake their functions as directors with due care, diligence and skill.

The constitutional documents of a Cayman Islands PE fund will usually contain indemnification provisions in favour of the general partner in the context of an ELP, or directors in the context of an exempted company and their respective affiliates for all liabilities, loss, damage, cost or expense, in the absence or fraud, wilful neglect or negligence (or other behaviour, such as dishonesty or gross negligence).

In the context of an exempted company, under the Companies Law, directors could also face criminal sanctions for criminal offences, including the following:

- fraud committed in the 12-month period prior to a winding up of the PE fund;
- misconduct in the course of a winding up of the PE fund; and
- making material omissions in statements relating to the company's affairs in the course of a winding up.

Subject to any express provision of the LLC agreement to the contrary, a manager of an LLC owes no duty (fiduciary or otherwise) other than a duty to act in good faith in respect of the rights, authorities or obligations of the manager. The good faith duty can be expanded or restricted, but not eliminated, by the express provisions of the LLC agreement. A member does not owe any duty (fiduciary or otherwise) to the LLC or to a member in exercising any rights or authorities, or performing any obligations, in respect of the LLC. In particular, the LLC Law provides that where a member is exercising any vote, consent or approval right, it may do so in its own best interests even though it may not be in the best interests of the LLC or any other member. The LLC Law also expressly provides that any person serving on any board or committee of the LLC may, if expressly permitted to do so by the LLC agreement, act in a manner which the person believes to be in the best interests of a particular member (even though it may not be in the best interests of all the members or the LLC).

The Cayman Islands Monetary Authority (CIMA) has issued a Statement of Guidance for Regulated Mutual Funds (the Statement), in which it sets out CIMA's expectations regarding the corporate governance regime of regulated mutual funds. In essence, CIMA expects the oversight, direction and management of a regulated mutual fund to be conducted in a fit and proper manner. Accordingly, the purpose of the Statement is to provide the governing body of a regulated mutual fund (Governing Body) and its operators (Operators) with guidance on the minimum expectations for the sound and prudent governance of the regulated mutual fund.

The Statement provides guidance for the Governing Body on matters such as: monitoring of a funds compliance with applicable laws, regulations and rules; oversight and supervision of the service providers to the funds; frequency of Governing Body meetings and service provider representation at such meetings; reporting by the investment manager and service providers; and identification and recording of conflicts of interest. The Statement also provides a non-exhaustive list of duties that CIMA considers applicable to an Operator, for example: ensuring it has capacity to apply its mind to oversee and supervise each regulated fund of which it is an operator; and ensuring the roles and responsibilities of all service providers are clearly defined, understood and are being adequately performed.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Gross negligence (as opposed to 'negligence') is not a fully recognised legal term under Cayman Islands law. However, gross negligence is often referred to in the constitutional document or agreements of a PE fund, but is usually defined either by reference to the laws of a jurisdiction that recognises gross negligence (eg, the state of Delaware in the United States) or is specifically defined in the relevant document.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Most of the special issues or requirements particular to PE funds structured as limited partnerships are governed by the terms of the partnership agreement. Typically, the partnership agreement will contain provisions stating the following:

- a limited partner may only transfer its partnership interests subject to the express terms of such agreement;
- the general partner may appoint or remove the investment manager of the PE fund; and
- advisory committees may be created (which are internal bodies that consent to, or approve of, certain actions by the general partner), the members of which can include limited partners. Limited partners who are members of these committees should read the terms of these advisory committees carefully to ensure that actions taken via an advisory committee are not deemed to be managing the affairs of the ELP and thereby risk losing their limited liability status.

Any limited partnership established under the laws of a jurisdiction other than the Cayman Islands may (provided that the laws of the foreign jurisdiction where it is organised permit or do not prohibit such a transfer), at any time upon effecting such amendments to the partnership agreement as shall be necessary to comply with the ELP Law and upon filing the required documents, be registered under the ELP Law, transfer by continuation to the Cayman Islands and, with effect from the date of the Certificate of Registration issued by the Registrar, would then be governed as an ELP in accordance with the ELP Law.

Where a limited partnership migrates to the Cayman Islands, the ELP and the partnership interests of its partners and their rights and liabilities, as against any person who is not a partner, shall cease to be governed by the laws of the jurisdiction from which it has migrated, with effect from the date indicated on the Certificate of Registration issued by the Registrar. However, any act or omission occurring before such date shall continue to be governed by such law or the laws of such other jurisdiction, provided always that such registration of the migrated limited partnership in the Cayman Islands as an ELP shall not operate to do any of the following:

- create a new legal entity;
- affect the property previously acquired by or on behalf of the ELP;
- affect any act or thing done prior to such registration or the rights, powers, authorities, functions or obligations of the ELP, any partner or any other person prior thereto; or
- render defective any legal proceedings by or against the ELP or any partner or any other person, and any legal proceedings that could have been continued or commenced by or against the ELP or any partner or any other person before its registration hereunder may, notwithstanding such registration, be continued or commenced after such registration and in respect of which such law or the laws of such other jurisdiction shall be of application.

The partnership agreement is typically modified to reflect requirements of the ELP Law.

A qualified transferring foreign company incorporated under the laws of a jurisdiction outside the Cayman Islands may continue by way of transfer into the Cayman Islands, provided that the laws of the foreign jurisdiction where it is incorporated permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity. The transferring foreign company is effectively taken from the foreign jurisdiction and redomiciled in the Cayman Islands as the same legal entity, but now governed by Cayman Islands law rather than the law of the foreign jurisdiction.

A qualified transferring foreign entity formed, registered, incorporated or existing under the laws of a jurisdiction outside the Cayman Islands may continue as an LLC by way of transfer into the Cayman Islands, provided that the laws of the foreign jurisdiction where it is

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incorporated permit or do not prohibit such a transfer. Such transfer by way of continuation does not create a new company or other new legal entity. The transferring foreign company is effectively taken from the foreign jurisdiction and redomiciled in the Cayman Islands as the same legal entity, but now governed by Cayman Islands law as an LLC rather than the law of the foreign jurisdiction.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Under Cayman Islands law, there are no statutory or regulatory consequences in this regard except that, to the extent that such bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor necessitates, in the case of an ELP, a change of general partner of the ELP, a successor general partner should be appointed and the Registrar should be notified of the change in general partner. In the unlikely event that the PE fund is registered with CIMA, CIMA should be notified of the change in sponsor or a change of the PE fund's investment manager. The terms of the limited partnership agreement of the PE fund, the LLC agreement of the PE fund (where it is structured as an LLC) and the memorandum and articles of association of the PE fund (where it is structured as an exempted company) will typically assist in determining the consequences of the sponsor of the PE fund being faced with bankruptcy, insolvency, change of control, or restructuring.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The principal regulatory body in the Cayman Islands for investment funds and investment managers is CIMA. PE funds are typically structured to be exempt from the application of the Mutual Funds Law and therefore are not required to register with CIMA because the investor's partnership interests or shares are not redeemable or repurchasable at the investor's option and therefore do not fall within the Mutual Funds Law definition of 'equity interests'.

A CIMA-registered PE fund (ie, one where the partnership interests, shares or limited liability company interests) are redeemable at the option of the investor and has more than 15 investors) is required to prepare and submit annual audited financial statements to CIMA. CIMA may require such information or such explanation in respect of the PE fund as it may wish to carry out its duties under the Mutual Funds Law. A CIMA-registered PE fund must give CIMA access to or provide at any reasonable time all records relating to the PE fund. The Mutual Funds Law provides for substantial fines for failure to comply with any such requests by CIMA and CIMA may apply to the court to have the PE fund wound up.

Unless exemptions apply, an investment manager of a PE fund may be required to obtain a licence under the Securities Investment Business Law (2015 Revision) (SIBL) if it is incorporated or registered, or has an established place of business, in the Cayman Islands (see question 12).

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

A PE fund may be required to register with CIMA under the circumstances outlined in question 10. A PE fund is prohibited from doing business with the public of the Cayman Islands (other than so far as may be necessary for the carrying on of its business outside of the Cayman Islands).

The Cayman Islands' Director Registration and Licensing Law, 2014 (as amended) requires all directors, whether resident in the Cayman Islands or non-resident, of regulated mutual funds and companies which maintain a registration as an excluded person pursuant to the SIBL to register with CIMA. Persons who hold more than 20 of such directorships will need to be licensed by CIMA and will be subject to enhanced regulatory requirements. Corporate directors, irrespective of directorship numbers held, will also need to be licensed by CIMA. Therefore all directors of CIMA-registered PE funds and their Cayman Islands management companies (holding the SIBL exemption – see question 12) will have to be registered with CIMA. A fee is payable upon application for registration or licensing. In addition, each such director will be required to make an annual filing each year with CIMA together with the payment of a fee, and if there are any changes to the information supplied to CIMA on registration or in any subsequent annual filing, the director concerned will be required to inform CIMA within 21 days of the change.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Investment managers that are vehicles incorporated or registered in the Cayman Islands, or any person or entity incorporated anywhere else in the world but with an established place of business in the Cayman Islands through which securities investment business is carried on, will be governed by the provisions of the SIBL and its licensing requirements. The following is a non-exhaustive list of persons that may be registered as an 'excluded person':

- one of a group of companies carrying on securities investment business exclusively for one or more members of its group;
- a person carrying on a securities investment business exclusively for:
  - a sophisticated person (as defined in the SIBL);
  - a high-net-worth person (as defined in the SIBL); or
  - a person who is regulated in respect of such securities investment business by a recognised overseas regulatory authority.

In order to register, such excluded person must:

- complete and submit to CIMA the Annual Declaration Form for Excluded Persons; and
- submit the annual fee of approximately US$6,000.

Normally, PE fund managers are able to qualify for registration as an excluded person under SIBL.

As mentioned in question 11, directors of an 'excluded person' which is a company must also register with CIMA.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

If the PE fund's investment manager is registered as an excluded person under the SIBL, as mentioned in questions 11 and 12, the directors of an investment manager which is a company must be registered with CIMA or where the director holds 20 or more directorships of mutual funds or excluded persons, licensed by CIMA. Where the SIBL does not apply to an investment manager, there will be no qualifications or licensing requirements required under Cayman Islands law for the PE fund manager and its principals or directors.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are currently no such Cayman Islands rules or policies applicable to PE funds.

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15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are currently no such Cayman Islands rules or policies applicable to PE funds.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are currently no such legal or regulatory developments in the Cayman Islands applicable to PE funds.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Under current Cayman Islands law there are no Cayman Islands taxes on income or gains of the PE fund or on gains on dispositions of shares or partnership interests, and distributions made by a PE fund will not be subject to withholding tax in the Cayman Islands.

As an ELP, a PE fund has the ability to apply for, and could expect to obtain, an undertaking from the governor-in-council of the Cayman Islands (the governor) pursuant to the provisions of the Tax Concessions Law that for a period of 50 years from the date of exemption no law enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains shall apply to it or its operations, and that any such tax or any tax in the nature of estate, duty or inheritance tax shall not be payable on the partnership interests, debentures or other obligations of the PE fund or by way of the withholding in whole or in part of any payment of divided or other distribution of income or capital by the PE fund to its partners or payments of principal or interest or other sums due under a debenture or other obligation of the PE fund. If the PE fund is structured as an exempted company, it can also apply to the governor for an exemption for a period of 20 years and, if the PE fund is an LLC, it can also apply for an exemption for a period of 50 years.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

No, see question 17.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

No, see question 17.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are currently no significant organisational taxes in the Cayman Islands. However, there are registration and annual maintenance fees payable to the government of the Cayman Islands in connection with the registration or incorporation of a PE fund in the Cayman Islands, as described previously.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Currently, none. See question 17.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

As of 1 July 2005, the EU Savings Directive (2003/48/EC) (EUSD) became effective. The EUSD requires withholding of tax or exchange of tax information on interest paid to EU-resident individuals and certain EU intermediary entities in certain limited circumstances. The Cayman Islands government entered into bilateral agreements with each of the member states of the European Union in relation to reporting of savings income information and passed laws implementing those agreements. Distributions made by a PE fund or income derived from the sale or redemption of the shares should generally not be subject to the EUSD withholding tax or exchange of information. However, if an investor in a PE fund were to hold its shares through a professional nominee that is based in an EU member state, it is possible that the EUSD may apply to distributions made by the PE fund to the investor or to the income derived by the investor from the sale or redemption of the shares in the PE fund. Whether the EUSD would apply in any given case would depend upon the circumstances surrounding the relevant investor and the manner in which the EUSD has been implemented in the relevant EU member state. With the implementation of the Common Reporting Standard (CRS), which is broader in scope than the EU Savings Directive, such Directive has been repealed and it is anticipated that any reporting under the Directive will be replaced with reporting under the CRS from 2017.

The Cayman Islands has signed over 36 tax information exchange agreements (TIEAs) with other countries, of which 31 were in force as at November 2017, including most EU member states (the Czech Republic, Denmark, Finland, France, Germany, Ireland, Italy, Malta, the Netherlands, Norway, Poland, Portugal, Sweden, the United Kingdom), Argentina, Aruba, Australia, Canada, China, the Faroe Islands, Greenland, Guernsey, Iceland, India, Isle of Man, Japan, Mexico, New Zealand, South Africa and the United States, and as a result is on the Organisation for Economic Co-operation and Development (OECD) 'white list' of jurisdictions that have substantially implemented international tax standards. Essentially, TIEAs are bilateral agreements under which jurisdictions agree to cooperate in tax matters through the exchange of information. The Cayman Islands has also joined the Convention on Mutual Administrative Assistance in Tax Matters, which was developed by the OECD and the Council of Europe to combat tax evasion and aggressive tax avoidance. It provides for all possible forms of administrative cooperation between states in the assessment and the collection of taxes.

The Foreign Account Tax Compliance Act (FATCA) was introduced by the United States in 2010 as part of the Hiring Incentives to Restore Employment Act with the purpose of reducing tax evasion by its citizens. The Cayman Islands has entered into a Model 1B Intergovernmental Agreement (IGA) with the US relating to FATCA and also an agreement to improve international tax compliance with the United Kingdom (based on the US Model 1 IGA). The Cayman Islands has also introduced legislation that implements FATCA, and also what is known as UK FATCA (or CDOT), under which Cayman Islands financial institutions (which would include most funds) are required to, inter alia, conduct due diligence on their account holders (ie, investors) to determine whether they are US or UK persons; and report on an annual basis certain information to the Cayman Islands Tax Information

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Update and trends

The Anti-Money Laundering Regulations 2017 (the Regulations) were brought into force on 2 October 2017 and replace the Money Laundering Regulations (2015 Revision) (the Former Regulations).

The principal aim of the Regulations is, as the name suggests, to combat money laundering and the financing of terrorism. Rather than bringing about wholesale changes, the Regulations are really a further iteration of the regime set out in the Former Regulations and the accompanying Guidance Notes on the Prevention and Detection of Money Laundering and Terrorist Financing in the Cayman Islands (the Guidance Notes). The Regulations codify some of the recommendations previously set out in the Guidance Notes and also seek to more accurately reflect the 2012 recommendations of the Financial Action Task Force.

One of the principal changes is the extended scope of the Regulations. The Former Regulations applied to those who conducted 'relevant financial business', as such term was defined therein. However, the Regulations now refer to the definition of 'relevant financial business' set out in the Proceeds of Crime law (2017 Revision). This definition, importantly, has extended the list of activities that constitute 'relevant financial business' to specifically include 'investing, administering or managing funds or money on behalf of other persons'. Accordingly, regulated and unregulated investment entities and finance vehicles (including private equity and closed-ended funds) are within the scope of the Regulations and will be required to comply with them.

This requires the establishment and maintenance of various procedures for due diligence of the relevant entity's investors, the training of its employees, the appointment of certain officers and the reporting of any issues.

The Regulations are in force as of 2 October 2017 but, in order to provide sufficient time for those entities that are now finding themselves subject to this regime to be compliant, there will be no enforcement against them until 31 May 2018.

The revised Guidance Notes, when issued, are expected to contain a specific section detailing how a closed-ended/unregulated fund should ensure compliance.

Authority (TIA). The legislation permits the Cayman Islands government to exchange tax information automatically with the UK and the US without violating Cayman Islands law.

On 16 October 2015, the Cayman Islands issued regulations relating to the CRS, the OECD initiative for the global automatic exchange of information for tax purposes. As with FATCA, the CRS regulations require Cayman Islands reporting financial institutions to, inter alia, establish policies and maintain procedures designed to identify reportable accounts from 1 January 2016 (which include the identification of each jurisdiction in which an account holder or controlling person is resident for tax purposes, application of certain due diligence and retention of information obtained or a record of the steps taken to comply with the CRS Regulations for six years) and file an annual report with the TIA setting out certain information on reportable accounts.

We expect many of the sponsors of PE funds will outsource to administrators the reporting requirements imposed on them by the increased regulation and will rely on the administrators to ensure full due diligence is conducted with respect to the investors in their funds. In any event, managers should remain vigilant in their compliance with the FATCA and CRS legislation.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Currently, none. See question 17.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

A Cayman Islands PE fund is not allowed to carry on business with the public of the Cayman Islands other than so far as may be necessary for the carrying on of the business of the PE fund outside of the Cayman Islands. As such, Cayman Islands PE funds are prohibited from offering shares to the public in the Cayman Islands (in the case of an exempted company) unless such shares are listed on the Cayman Islands Stock Exchange.

'Public', for these purposes, does not include a sophisticated person, a high net worth person, a company, partnership or trust of which the shareholders, unit holders or limited partners are each a sophisticated person, a high-net-worth person any exempted or ordinary non-resident company registered under the Companies Law or a foreign company registered pursuant to Part IX of the Companies Law or any such company acting as general partner of a partnership registered pursuant to the provisions of the ELP Law or any director or officer of the same acting in such capacity or the Trustee of any trust registered or capable of registering pursuant to the provisions of the Trusts Law (as revised).

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are currently no other Cayman Islands restrictions to describe.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Save where the PE fund constitutes a financial institution for the purposes of FATCA or the CRS and is thereby obliged to make annual notification filings to the TIA in respect of relevant investors (see question 22), there are no filings or notifications required as regards investors in an exempted company, LLC or an ELP. However, as noted above, the general partner must maintain a register of limited partners that is open to inspection by all partners of an ELP or by any other person with the consent of the general partner of the relevant ELP. In addition, the general partner must file a statement with the registrar of exempted limited partnerships where there has been a change in any of the information provided under the section 9 registration filing described in question 2.

In the unlikely event that the PE fund is to be CIMA-registered, in order to effect the required registration, the PE fund is required to provide CIMA with a summary of the terms of the offering for each class of equity interests and to provide details of the various service providers of the PE fund along with a copy of its offering document. The PE fund must notify CIMA of any changes in the details of the summary of the terms of the offering and any change in the PE fund's service providers as filed on initial registration with CIMA and supply copies of any supplements to, or revision of, the offering document.

The directors of a CIMA-registered PE fund or manager holding a SIBL exemption will be required to make an annual filing together with the payment of a fee, and if there is any change to the information previously provided, the director must inform CIMA of the change within 21 days of the change.

The PE fund usually will require evidence identifying the branch or office of the bank from which subscription monies are being remitted or have been transferred, to verify that the account is in the name of the subscriber and retain a written record of such details. Normally the PE fund and its general partner (or directors if it is an exempted company) reserve the right to request such information as is necessary to verify the identity of a subscriber. Any failure or delay by a subscriber to produce

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any information required for verification purposes could result in the PE fund refusing to accept the subscription application and the subscription monies relating thereto.

If any person who is resident in the Cayman Islands (including the general partner or a director) has a suspicion that a payment to the PE fund (by way of subscription or otherwise) contains the proceeds of criminal conduct, that person is required to report such suspicion pursuant to the Proceeds of Crime Law (2014 Revision).

Pursuant to an agreement made between the governments of the Cayman Islands and the UK in April 2016, the Cayman Islands implemented legislation on 1 July 2017 that requires certain Cayman Islands companies and limited liability companies to maintain beneficial ownership registers at their registered offices and for the information contained in such registers to be stored in encrypted form on a secure standalone search platform operated by the Cayman Islands government (the Search Platform). The principal purpose of the legislation is to make beneficial ownership information normally held by corporate service providers readily accessible in response to proper and lawful requests from specified law enforcement agencies (currently only those located in the Cayman Islands or the UK). The Search Platform will not be publicly accessible and may only be searched by the Cayman Islands authorities following a request by one of the specified law enforcement agencies.

There are various exclusions to the requirement to maintain beneficial ownership registers. The most obvious of these is that the beneficial ownership regime does not apply to exempted limited partnerships. In addition, companies or limited liability companies that are registered under the Mutual Funds Law (2015 Revision) or managed or operated by an approved person (ie, someone regulated in the Cayman Islands or another approved jurisdiction, such as the US) as an investment fund or private equity fund (or is a general partner of such an entity). This should exclude most, if not all, private equity funds from needing to maintain beneficial ownership registers. In any event, as the threshold for registration of a beneficial owner is more than 25 per cent of the shares/interests or voting rights, it is unlikely that a private equity fund would need to include anyone in its beneficial owner even if it were not excluded.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Usually, the person offering interests in a PE fund will be the investment manager or sponsor of the Fund and, unless such person is domiciled in the Cayman Islands or carries on business in the Cayman Islands, there will be no requirement for that person to obtain licences or registration in the Cayman Islands provided that such PE fund is not offering interests redeemable at the option of investors and no registration with CIMA is required.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The PE fund will be subject to the provisions of the Cayman Islands Anti-Money Laundering Regulations and Proceeds of Crime Law of the Cayman Islands. To comply with these regulations and laws aimed at the prevention of money laundering and terrorist financing, the PE fund typically requires prospective investors to provide evidence to verify their identity. The general partner of the PE fund where it is structured as an ELP or the board of directors where it is structured as an exempted company usually reserve the right to request such information as it considers necessary to verify the identity of a prospective investor.

As Cayman Islands-based PE funds will typically be considered financial institutions, they will be required to undertake due diligence on their investors to identify whether they are US or UK specified persons (for FATCA purposes) and where they are tax resident (for CRS purposes) and disclose certain information to the TIA (see question 22).

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

It is possible for a PE fund established as either an ELP or an exempted company to apply for a listing on the Cayman Islands Stock Exchange (CSX), but it would be unusual for a PE fund to do so. The principal advantage of obtaining a listing is that the PE fund's securities would be listed on a recognised exchange, which some institutional investors may require. However, the main disadvantage would be that it would add another layer of expense and formation procedures, which may not be necessary in order to facilitate a private equity transaction. The CSX listing rules are available online at www.csx.com.ky, and the principal initial and ongoing requirements for listing are set out in Chapter 9 of the CSX listing rules.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Chapter 9 of the CSX listing rules provides that securities must be freely transferable, but certain transfer restrictions are allowed if they are adequately disclosed and approved by the CSX, such as where transfer restrictions are required in order to avoid breaching the securities laws of any relevant jurisdictions.

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Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are currently no such restrictions under Cayman Islands law.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Other than the fiduciary duty of the general partner of an ELP to act in good faith and, subject to the express terms of the partnership agreement to the contrary, in the interests of the ELP, the duty of a manager of an LLC to act in good faith (subject to the provisions of the LLC agreement) and the fiduciary duties of the directors of an exempted company, there are currently no specific legal or regulatory issues under Cayman Islands law that affect compensation and profit-sharing arrangements of a PE fund. The structuring of such arrangements in a Cayman Islands PE fund is usually driven by the legal or regulatory requirements of certain onshore jurisdictions.

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China

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In the People's Republic of China (PRC for the purposes of this chapter, excluding the Hong Kong Special Administrative Region and the Macao Special Administrative Region), private equity funds are typically formed as limited partnerships. Other vehicles are also used in certain contexts, such as limited liability companies, companies limited by shares or a contractual type fund. A contractual type fund is, essentially, a collective investment scheme managed by a fund manager without a legal vehicle. These funds are substantially similar to undertakings for collective investment in transferable securities or unit trust funds in other jurisdictions, although focused on private equity investments.

A limited partnership must register at the Administration of Industry and Commerce (AIC) (equivalent to the Company Registry in other jurisdictions) as a standalone legal entity, but 'without an independent legal personality' (ie, it is not considered a standalone entity in certain cases). The general partner of a limited partnership bears unlimited joint and several liability for the actions of the partnership, but the limited partners only bear liabilities capped at their capital commitments to the partnership. The general partner typically acts as the fund manager, but it is also possible to appoint a third party, external fund manager.

A limited liability company or a company limited by shares (in either case, a 'company') must also register at the AIC. The main difference is that a company maintains a standalone legal personality and existence.

A contractual type fund does not have a standalone existence, nor does it need to register at the AIC. It is considered a collective investment scheme or a contractual arrangement between the investors and the fund manager.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

It typically takes about 10 to 20 working days to incorporate a private equity fund vehicle in the form of a limited partnership or a company once all documents are duly executed, submitted to and accepted by the AIC. The formation of a contractual-type fund is deemed complete once the constituent contract (fund contract) is executed by all initial investors.

Under the current regulatory scheme, any PRC private equity fund should be managed by a fund manager duly registered with the Asset Management Association of China (AMAC). Specifically, the fund manager must submit a registration application (including a legal opinion issued by a qualified PRC law firm) through AMAC's online Asset Management Business Electronic Registration System (AMBERS). This can be a potentially time-consuming process, as AMAC may take up to 20 working days to review an application and provide feedback and amendment suggestions, usually along with a supplement to the legal opinion. Each subsequent review by AMAC of the amended application will also take up to 20 working days. An applicant may amend an application five times before AMAC institutes a hold period of three months before the applicant can further amend the application. In our experience, however, fund managers can generally complete the process with AMAC within one to three amendments.

The fund manager should make a filing with AMAC for each fund under his or her management after the fundraising phase. Similar to fund manager registration, AMAC may take up to 20 working days to review each initial filing application and subsequent amendments.

The above timeline does not include other necessary preparatory time for fund operation (eg, incorporation of the fund manager, execution of all incorporation and constituent documents for the fund, opening a bank account, etc).

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A limited partnership or a company is required to maintain a registered office. A contractual fund does not have a registered office.

A company must duly keep its books and records. The fund manager of a fund in the form of a limited partnership or a contractual fund should be responsible for keeping the books and records of the fund.

Generally, there are no specific requirements to maintain a fund custodian or administrator for limited partnerships or companies. An exception is that for fundraising purposes, all private equity funds are required to maintain a separate fundraising account, over which the bank with which the account is held will have certain supervisory authorities. This account, however, is not a full custodial account, as the supervisory powers of the bank are generally limited. However, use of custodian banks (which also administer the fund, to some extent) are encouraged. Otherwise, the fund manager will often be required to submit to AMAC a limited partnership agreement and a non-custodian agreement between the fund manager and the fund's investors.

A contractual type fund must maintain a custodian bank account to hold all fund assets. The purpose of this account is to keep the assets of the fund independent of those of the fund manager.

There is no legal requirement in China to maintain a corporate secretary.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Information related to the private equity fund can be accessed from the information disclosure system on AMAC's official website.

If a fund manager fails to disclose required information or discloses false information with respect to itself or a fund managed by it, AMAC will issue a warning or even add the fund to a blacklist. The warning will be made public on AMAC's disclosure webpage. In some

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circumstances, an investigation by the China Securities Regulatory Commission (CSRC) will be triggered.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

With respect to a limited partnership, the limited liability of a limited partner may be forfeited if the limited partner is deemed to have participated in the operation or management of the limited partnership or both.

With respect to a company, the limited liability of a controlling shareholder may be forfeited where the theory of 'piercing the corporate veil' is applicable (ie, where the controlling shareholder is deemed to have exerted such control as to evade liabilities that would have otherwise been applicable to the shareholder).

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

According to PRC law, the fund manager should act honestly in performing its duty. As PRC law has no detailed provisions in this regard, the fiduciary duty of a fund manager is typically provided for in the fund's constituent document (ie, the limited partnership agreement in the case of a limited partnership, or the fund contract in the case of a contractual type fund). Over the past year, we have seen a number of cases in which AMAC has revoked the registrations of certain fund managers for fiduciary duty violations.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

According to PRC law, the fund manager is to be held responsible for any wilful acts. Few laws (eg, the Trust Law, which may be applicable in the case of a contractual type fund) recognise the 'gross negligence' standard of liabilities, as opposed to 'wilful acts' or 'ordinary negligence'. Nevertheless, it is also common practice to provide a contractual gross negligence standard of liability in the constituent document of a private equity fund.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The current regulatory scheme requires that investors of a private equity fund in China meet a 'qualified investor' standard. In addition, special prior government approval with respect to foreign direct investment is often required for foreign investors to participate in any private equity fund in China.

It is currently not possible to convert or redomicile private equity investment vehicles from other jurisdictions to the PRC. The Chinese government has recently tightened control over the formation of offshore blind-pool private equity funds by Chinese investors.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

If the private equity fund intends to cancel its AMAC registration, it will be required to sign a commitment letter and a statement, and file them through AMAC's online system. After AMAC approval, the private equity fund's registration will be officially cancelled.

According to the Partnership Law of China, if all general partners of a limited partnership become insolvent or cannot repay their debts, the partnership will be forced to dissolve and wind up.

As to changes of control, if the controlling shareholder or ultimate and actual beneficiary controlling party of the fund manager has changed, the fund manager must submit an online application with AMAC to update its registration profile supported by a special legal opinion issued by qualified lawyers for such change.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The CSRC is currently the regulatory body for private equity funds in China. In practice, however, the CSRC entrusts the regulatory work of private equity funds to AMAC.

All private equity funds filed with AMAC are required to submit semi-annual financial reports and quarterly updates of financial and non-financial information to AMAC and timely updates of certain significant changes. The current regulatory framework does not provide explicit inspection rights to AMAC, although AMAC will occasionally call or visit fund managers for inspection purposes. The CSRC and its local supervisory bureaux may exercise inspection rights proactively if there is any suspicion of non-compliance. In addition, we have seen a number of random on-site inspection campaigns launched by local securities supervisory bureaux against private fund managers in the past year.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

A fund manager should register with AMAC and then file any fund that it manages with AMAC. In addition to ordinary AMAC filings, special government approvals in relation to foreign investment are required for fundraising foreign managers in China, or foreign investors investing in PRC funds.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

According to current CSRC regulations, a private equity fund manager must have been registered with AMAC for at least one year before it can act as an investment adviser. In addition, the adviser must employ at least three qualified investment officers with over three years of investment experience to provide such services. AMAC has also released a list of documents that a private equity fund manager has to file with AMAC before providing investment advisory services. These documents mainly concern the fund manager's credentials, track record and the prior work experience of its officers.

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13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

AMAC requires fund managers to comply with a set of criteria including business scope, registered capital, employees, officers and directors, etc. The business scope of a private equity fund manager must be very specific and limited to investment management business only (eg, its business scope should contain 'investment management' or equivalent language and should not include unrelated or conflicting items).

Managing officers of a fund manager of a private equity investment fund registered with AMAC must obtain fund qualification and have ample experience with investment business. AMAC also requires that officers (not necessarily directors) of a fund manager be employed full-time and solely by the fund manager. The only exception is that the legal representative of the fund manager may also act as legal representative of an affiliate of the fund manager.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There is no direct rule regarding political donations by a private equity fund. Nevertheless, a private equity fund's donation activity is subject to the rules regarding general donations.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There is no direct legal rule restricting or requiring disclosure by a private equity fund's manager or investment adviser of the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities in China. Nevertheless, public pension plans and other governmental entities usually have similar disclosure requirements in the relevant bidding processes when selecting fund managers.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Commercial banks in China are not allowed to directly invest in or sponsor private equity funds in China. The banks may, however, use standalone subsidiaries that are cut off from the banking system to invest in private equity funds. In addition, subsidiaries of commercial banks in the asset management industry may now act as fund managers pursuant to the relevant PRC laws.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

The limited partnership is considered a pass-through entity with regard to income tax (ie, no income tax is levied at the partnership level and each of the partners pays its own income tax). However, the local practice varies in different provinces of China with regard to waiver of value added taxes (VAT).

A company is not a pass-through entity and pays its income tax in accordance with the Enterprise Income Tax Law, and individual investors pay individual income tax in accordance with the Individual Income Tax Law. In addition, the company should pay value added tax for each sum of income.

A contractual type fund trading securities is considered a pass-through entity. However, because the fund manager typically holds all underlying assets of the fund in the manager's name, it remains unclear whether the fund manager can obtain tax exemptions for proceeds it receives on behalf of a private equity fund under its management taking the form of a contractual type fund.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors who do not establish an organisation or premise in China, or whose income has no actual relation to its local organisation or premises, are subject to withholding taxes (typically at a rate of 10 per cent, absent any preferential tax treaties). However, tax exemptions may apply to income from equity investment, including any dividends and bonuses obtained from resident enterprises by non-resident enterprises with institutions or establishments in China (but only where there is an actual relationship between such institution or establishment and the income). For non-resident individual investors, equity investment income is subject to withholding tax at a rate of 20 per cent.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

A private equity fund in the form of a partnership or a company will need to go through a tax registration process upon incorporation, which will determine its applicable tax rate. Further, private equity funds are often required to obtain a ruling from the local tax authorities regarding special tax exemptions or rebates (ie, special tax holidays available to private funds investing in small or medium-sized enterprises).

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There is no special organisational tax applicable to private equity funds in China in addition to the income tax and value added tax, as discussed above.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

The designers and stakeholders of a private equity fund (eg, the general partner and limited partners of a limited partnership) may consider setting up the fund in certain cities to benefit from preferential income tax

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Update and trends

The key buzzwords in the market in the past year have been compliance and regulation. AMAC and other regulators of the private equity fund industry and the broader asset management market have displayed their determination and regulatory strength through the promulgation of new regulations and enforcement actions against offenders. In short, market entry for unsophisticated fund managers is less easy than before, which could be a good news for existing market players who play by the rules.

On the other hand, we have also seen a number of foreign market giants enter the Chinese market and obtain fund manager registration with AMAC. We believe a more regulated market will eventually create a level playground for all market players in the fund management industry and eventually create more value for investors.

rates (eg, 15 per cent) and a tax rebate (eg, a certain percentage of the total value added tax and income tax levied).

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

China has entered into bilateral tax treaties with more than 80 countries in order to avoid double taxation. Whatever the legal form used for the private fund, the tax treaties will usually affect foreign investors in private funds formed both within China's jurisdiction and outside of it.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

In order to encourage the development of private equity transactions in China, some municipalities (eg, Qianhai Development Zone of Shenzhen and Shanghai Pudong District) have issued directives that contain preferential tax policies regarding such transactions. These tax policies and incentives may vary in terms of how they are ultimately applied to each fund and its investors.

Although delayed several times, the PRC government has officially begun to levy VAT on asset management business (including on PE funds via PE fund managers) since 1 January 2018.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

As mentioned above, private equity funds may only be offered to qualified investors. In addition, private funds cannot solicit or market to the general public.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

As discussed above, an investor of a private equity fund in China should be a qualified investor. Special approval from the Ministry of Commerce and its local branches (collectively, MOFCOM), is required for foreign investors to invest in private equity funds in China.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The fund manager should maintain records of investors. In the case of a partnership or a company, the fund manager should also file with the relevant AIC with regard to any change of partnership or shareholding.

The fund manager is also required to report to AMAC if there is any change in its own composition of ownership, management or control.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Currently, interests in a private investment fund can only be offered or marketed by:

- a private fund manager duly registered with AMAC, if the interests being offered are in a fund managed by the fund manager itself; or
- a qualified fund sales agency that is registered with the CSRC and is a member of AMAC, and has been entrusted by the fund managers of one or more of the funds being marketed.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The manager of a private equity fund is required to verify the source of wealth of investors of the fund. In practice, this is often done by requiring the investor to sign a declaration of the source of income to declare that all monies the investor invests in the fund are self-owned wealth derived from legitimate sources.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

On 27 May 2016, China's National Equities Exchange and Quotations (NEEQ) (similar to the over-the-counter trade system in the United States) released specific listing requirements for private equity funds and managers. These regulations provide several specific thresholds for private equity fund revenue, operation history capital contribution, fund managers and officers and assets under management. Moreover, private equity funds also need to conform to specific information disclosure rules, such as management models, establishment and daily management, fund investment and fund liquidation.

Over the past year we have not seen any successful new listings of private equity funds or fund managers on NEEQ. In addition, it is not customary for private equity funds or fund managers to list on the two A-share stock exchanges in Shenzhen and Shanghai.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

A NEEQ-listed fund may only offer its interests to qualified investors in NEEQ. In addition, the fund may also set up certain restrictions on the transfer of its interests, such as the lock-up terms on interests held by its senior officers or controlling shareholders.

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Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Investments made by private funds are regulated in the same way as investments by a regular private vehicle. Private funds with foreign capital are restricted or prohibited with respect to investing in certain industries or sectors in the same way as other foreign direct investment in China.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The key issue when considering compensation is taxation. This issue encountered by fund managers of private equity funds in China with respect to collection of management fees, transaction fees and carried interests is not specific to the private equity fund industry.

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Colombia

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Formation and terms operation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The choice of vehicle to be used for a private equity fund usually depends on whether the fund will target investments from Colombian institutional investors (such as pension funds and insurance companies) and its investment policies (ie, whether or not it intends to invest in Colombian publicly listed securities).

For the purposes of this chapter, we have assumed that the fund will be targeted at Colombian institutional investors and that its investment policy is aimed primarily at investing in assets other than Colombian publicly listed securities.

In this context, the legal form of vehicle typically used is a private equity fund, a vehicle specifically designed to allow Colombian institutional investors to invest in assets or rights other than Colombian-listed securities. (As a general rule, Colombian institutional investors are not allowed to invest in securities that are not publicly listed.)

Colombian private equity funds are a special type of 'closed-end portfolio investment fund', a legal mechanism contemplated by Colombian law to collect or manage sums of money or other assets, made up of the contribution of a several persons and to be managed in a collective manner to obtain collective financial results. Colombian regulation contemplates two main types of portfolio investment funds on the basis of the moment in which contributions can be made into the fund and the moment in which the contributions can be redeemed: 'open-end' funds, and 'closed-end' funds (the latter being funds that only allow contributions at preset times and, as a general rule, only allow redemptions at the predefined date (generally the end of the term of the fund).

Although Colombian private equity funds, as well as other portfolio investment funds, are not recognised as separate legal entities, assets held by each fund constitute an estate that is legally separate from the estate of the fund's investors, managers and its administrators.

Because the tax treatment afforded to institutional investors and foreign investors is different (institutional investors are, generally, not subject to Colombian income tax, while foreign investors are) many Colombian fund managers targeting both Colombian institutional investors and foreign investors will establish two parallel vehicles within the overall fund structure: a Colombian private equity fund and an offshore limited partnership structure (typically established in jurisdictions such as the Cayman Islands), that enter into a parallel investment agreement.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

Unlike other Colombian portfolio investment funds, Colombian private equity funds do not require an express authorisation from the Colombian Financial Superintendency (SFC) to be incorporated. Instead, the relevant fund administrator must submit the following information to the SFC, prior to the start of operations of the private equity fund:

- the draft of the private equity fund's by-laws (the equivalent to the limited partnership agreement used in other jurisdictions);
- a copy of the minutes of the board of directors of the fund administrator that approves the creation of the private equity fund;
- a certificate from the legal representative of the fund administrator indicating that it complies with the requirements described above;
- a facsimile of the document that evidences the investor's interest in the private equity fund; and
- the profile of the persons who will participate on the investment committee and who will manage the private equity fund.

The fund will be deemed authorised if the SFC does not state otherwise within the 10 days following the filing of information. Thereafter, the private equity funds will be subject to the regulatory control of the SFC.

However, the SFC will withhold information required for the fund to comply with its reporting obligations until it is satisfied that the fund's by-laws are consistent with applicable law and regulation. In practice, this means that some sort of authorisation from the SFC is required, which is inconsistent with the regulation that expressly states that private equity funds do not require authorisation from the SFC. Unsurprisingly, sponsors rarely contest the SFC's position.

Colombian private equity funds must have at least two investors, who must invest at least 600 minimum monthly salaries, in aggregate. Investors will receive rights to the private equity fund, which will be in the form of securities that may be publicly traded, if so established in the fund's by-laws.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

From a regulatory perspective, a Colombian private equity fund may only be established by the fund's administrator. Only Colombian broker-dealers, trust companies and investment management companies are authorised to act as fund administrators.

In practice, the initiative to establish a Colombian private equity fund rarely comes from the fund's administrator. Typically, it is the fund's prospective manager who will take that initiative and, at some point in the fund's promotion process, engage a registered broker-dealer, trust company or investment manager to act as the fund's administrator.

The fund administrator is in charge of all operational matters (such as acting as legal representative, keeping books and records and acting as corporate secretary). In principle, it is also in charge of managing the private equity fund. This includes anything from implementing the investment plan of the fund, assessing the risks associated with the fund's activities, collecting moneys owed to the fund, paying the distributions to the investors and keeping the fund's books and records.

However, when the fund administrator appoints a fund manager, the responsibility of the former for the implementation of the fund's investment plan will shift to the latter, and the fund administrator will

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remain liable with respect to investments solely for negligence in the selection of the fund manager or any failure in the supervision of the activities of the fund manager.

The fund manager may be an individual or entity, Colombian or foreign, that is an expert in the management of the type of assets that the particular private equity fund will hold. The fund manager must have sufficient experience and be well known in Colombia or abroad, and must comply with the experience, knowledge and reputation requirements described in the private equity fund's by-laws.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Access to information about a Colombian private equity fund will depend on whether its membership interests are publicly listed or not.

If the fund is not publicly listed, the information that the public is granted by law is limited to basic organisational information (such as the name, tax identification number, corporate address, the name of the fund administrator and the fund administrator's website URL).

If the fund is publicly listed, the information that the public is granted by law will also include financial statements, the by-laws of the fund, the valuation of the fund and any 'material information' regarding the fund. 'Material information' means any situation regarding the fund that would be taken into account by a prudent and diligent expert when deciding to buy, sell or keep membership interests in the fund, or when voting such membership interests. Among the events that are listed in the regulation, by way of enunciation, are the following:

- operations that generate variations of more than 5 per cent in the total value of the assets of the issuer;
- the sale of assets representing more than 5 per cent of the value of the relevant asset class;
- the change of control of the issuer; and
- changes in the ownership of 5 per cent of the issued and outstanding shares of the issuer.

The notes to the financial statements would include a list of the fund's 20 largest investors, and the number of membership interests held by each.

The information is accessed via the internet on the SFC's public information system (www.superfinanciera. gov.co/web_valores/Simev).

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Based on general principles applicable to other types of legal entity, the limited liability of third-party investors in a Colombian private equity fund would not be respected if the fund was used by third-party investors for the commission of fraud or with the intent of damaging third parties.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A Colombian private equity fund's administrator is, inter alia, required to do the following:

- conduct its administration activities exclusively for the benefit of investors;
- manage the fund's information as required to avoid conflicts of interest and the inappropriate use of confidential information;
- allocate the resources required for the fund to be properly administered, with personnel who are sufficiently independent from the administrator's own interests;
- report to the SFC any events or circumstances that hinder the administrator's ability to discharge its duties;
- ensure that the fund's personnel are complying with the applicable governance rules;
- adopt the measures require to avoid the fund from being used for fraudulent activities or for the purpose of damaging third parties; and
- afford all investors equal treatment.

The fund's manager is obliged to act in a professional manner, with the diligence that can be expected from a prudent and diligent person with expertise in the management of portfolio investment funds and observing the fund's investment policies and its by-laws. In particular, the fund's manager is obligated to invest the fund's assets as set out in the fund's investment policies and institute appropriate measures to follow up and supervise compliance with this obligation. The fund's manager is also expressly required to keep the fund's matters confidential, to report conflicts of interest to the fund's advisory committee and to heed the advisory committee's recommendations on how to manage such conflicts of interest.

These fiduciary duties cannot be modified by agreement of the parties.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Colombian law requires the fund's administrator to discharge its duties under an ordinary negligence standard of liability and the fund's manager to act with the diligence that can be expected from a prudent and diligent person with expertise in the management of portfolio investment funds.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Colombian private equity funds can only invest up to one-third of the investors' contributions in Colombian publicly listed securities.

No single pension fund can hold more than 40 per cent of a Colombian private equity fund's membership interests.

A Colombian private equity fund cannot invest in assets, membership interests or securities when the owner, seller or issuer of which is a pension fund manager that is an investor in that fund. The same applies to any affiliate of such pension fund manager.

Because the tax treatment afforded to institutional investors and foreign investors is different (institutional investors are, generally, not subject to Colombian income tax, while foreign investors are), many Colombian fund managers targeting both Colombian institutional investors and foreign investors will establish two parallel vehicles within the overall fund structure: a Colombian private equity fund and an offshore limited partnership structure (typically established in jurisdictions such as the Cayman Islands), that enter into a parallel investment agreement.

Conversion or redomiciling to vehicles in Colombia is not expressly prohibited, but prior attempts to do so have faced insurmountable practical obstacles.

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9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The bankruptcy, insolvency, change of control, restructuring or similar transaction of a Colombian private equity fund's sponsor are not expressly addressed in Colombian law or regulation and thus do not have legally prescribed consequences in Colombia.

Such circumstances are typically addressed in the fund's by-laws (usually by giving the investors the right to remove the fund manager).

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The main regulatory body that has authority over a Colombian private equity fund is the SFC.

The SFC's broad mission is to preserve public confidence and stability of the financial system by maintaining the integrity, efficiency and transparency of the stock market and other financial assets as well as ensuring the rights of financial users.

In furtherance of this general mission, the SFC is empowered to, inter alia, carry out the following:

- audit and inspect Colombian private equity funds, the funds' administrators and the funds' managers in order to examine their operations, assets and practices;
- interrogate officers and employees of the above, as well as third-party witnesses;
- order private equity funds to take the measures required to comply with the fund's investment policy and applicable regulatory limits;
- issue orders on how laws and regulations should be applied;
- impose fines on the funds' administrators and the funds' managers; and
- order the dissolution and liquidation of Colombian private equity funds.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Establishing a Colombian private equity fund does not require express governmental authorisation: the fund will be deemed authorised if the SFC does not state otherwise within the 10 days following the filing of the fund's by-laws with that entity. Thereafter, the private equity funds will be subject to the regulatory control of the SFC.

However, a Colombian private equity fund may only be established and administered by Colombian broker-dealers, trust companies and investment management companies.

Broker-dealers, trust companies and investment management companies are all entities that must be created and operate pursuant to Colombian regulation, under the supervision of the SFC, and the scope of what they can and cannot do is limited to what is expressly authorised under Colombian law. While broker-dealers and trust companies are heavily regulated in their incorporation and operation, investment management companies are less so. However, these entities must be incorporated following the same steps applicable to other financial entities and must have a significant minimum capital.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

The manager of a Colombian private equity fund does not have to register as an investment adviser, nor do any of its officers, directors or control persons.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The manager of a Colombian private equity fund may be any individual or entity, Colombian or foreign, that is an expert in the management of funds and in the type of assets that the particular private equity fund will hold. The fund administrator must have sufficient experience and be well known in Colombia or abroad, and must comply with the experience, knowledge and reputation described in the private equity fund's by-laws.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no rules in Colombia aimed specifically at private equity funds that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Public pension plans do not invest in private equity funds. A limited number of governmental entities (such as Bancoldex, a development bank) will invest, to the extent their charter expressly allows them to.

There are no rules in Colombia aimed specifically at private equity funds that restrict, or require disclosure of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities.

A bill of law recently approved by the Colombian Congress requires lobbyists to register as such and disclose, inter alia, the identity of their clients and the interests that they represent.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Colombian banks are only allowed to invest in securities and other assets that are expressly listed in applicable laws and regulations. Membership interests in private equity funds have not been on the list of permissible investments, since before the recent global financial crisis.

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Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Colombian private equity funds are 'fiscally transparent' for Colombian tax purposes. In other words, they are not subject to tax in Colombia, and their investors will be subject to tax in Colombia as if they were the direct owners of the fund's underlying assets.

Colombian private equity funds are, however, tax withholding agents, and will be required to withhold taxes on distributions to investors, as may be applicable depending on the tax treatment applicable to such investors. Institutional investors such as pension funds are, generally, not subject to Colombian income tax, and thus no withholdings will apply.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-residents without permanent establishment in Colombia are subject to income tax exclusively on their Colombian-sourced income. In general, Colombian-sourced income is defined as income derived from services rendered in Colombia, the transfer of any kind of assets that are located inside the country at the time the transfer takes place or the exploitation of assets located inside the country. Interest paid on foreign loans is defined as Colombian-sourced income as well. Income derived from services rendered outside the country, or from the transfer of any kind of assets that are located outside the country at the time the transfer takes place, or from the exploitation of assets located outside the country, constitutes foreign-sourced income. The base on which a foreign entity or individual is taxed in Colombia varies depending on whether the investor has established a business presence (a branch office or a Colombian affiliate) or created a permanent establishment in Colombia.

Because Colombian private equity funds are fiscally transparent for Colombian tax purposes, non-resident investors in a private equity fund will be subject to taxation on the distributions received from the fund, in the manner in which would have been taxed had they received the relevant amounts directly, as per the following examples:

- if the fund is distributing amounts corresponding to dividends paid by a portfolio company, such distributions would not, in principle, be taxed because Colombia does not tax dividends if the company paying the dividends was taxed on the profits from which the dividends are paid. Otherwise, the dividends would be subject to a tax withholding of 35 per cent;
- if the fund is distributing the profits derived from the sale of the shares of an underlying portfolio company, the distribution will be taxed at a rate of 10 per cent if the fund has held the shares for a minimum of two years, or at a rate of 33 per cent (plus 4 per cent surcharge if applicable) if the fund has held them for less than two years; and
- if the fund is distributing amounts corresponding to interest paid by a Colombian borrower of the fund, a 15 per cent income tax withholding would apply (5 per cent reduced rate available for financing of certain P3 projects).

Reduced withholding rates are available under double taxation treaties.

Non-resident investors are generally not subject to income tax return-filing requirements in Colombia if their income has been subject to applicable withholdings (ie, the amounts withheld are the final tax).

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

If there is any uncertainty regarding the local tax treatment of a private equity fund vehicle, a ruling from local tax authorities could be useful in dispelling such uncertainty.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant organisational taxes to be paid with respect to private equity funds organised in Colombia.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Taxation of the Colombian private equity fund's sponsor will depend on a variety of factors, including how the sponsor's income is characterised and whether or not the sponsor is a resident of Colombia.

As a general rule, the net taxable income of a Colombian resident sponsor will be subject to a combined corporate income tax of 37 per cent for 2018 .

However, certain conditions apply, as follows:

- if the carried interest can be understood to be a share of the capital gains triggered at divestment, the carried interest would be subject to a capital gains tax of 10 per cent if the fund has held the shares for a minimum of two years, or at the general income tax rate of 33 per cent (plus a 4 per cent surcharge if net taxable income is greater that COP 800 million (approximately US$233,000) if the fund has held them for less than two years;
- if the carried interest can be understood to be a share of the dividends generated by the target portfolio companies, the carried interest will be subject to the new income tax on dividends, which is equivalent to 5 per cent for dividends paid to non-resident individuals and entities out of profits taxed at the corporate level and 35 per cent for dividends paid out of profits non-taxed at the corporate level, plus an additional 5 per cent; or
- if the sponsor is not a Colombian resident and is not deemed to be effectively managed in Colombia, and the management fee or carried interest, or both, are characterised as fees for services rendered from abroad, then such fees would be subject to a 15 per cent withholding tax.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Colombia has double taxation treaties under the OECD guidelines in effect with Canada, Chile, the Czech Republic, India, Korea, Mexico, Portugal, Spain and Switzerland, and has signed treaties with France, Italy and the United Kingdom, which are still undergoing approval procedures. It is in the process of negotiating tax treaties with Belgium, Germany, Israel, Japan, the Netherlands, the United Arab Emirates and the United States. The Andean Community treaties (in force with Bolivia, Ecuador and Peru) also contain some double taxation provisions.

These double taxation treaties will typically reduce or eliminate Colombian tax on the income derived by a relevant treaty country resident (for example, capital gains received by a resident of Spain for the sale of shares of a Colombian portfolio company would generally not be taxed in Colombia, as opposed to a capital gains tax of 10 to 33 per cent (plus surcharge, where applicable) that would otherwise apply).

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23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Because the tax treatment afforded to institutional investors and foreign investors is different (institutional investors are, generally, not subject to Colombian income tax, while foreign investors are), many Colombian fund managers targeting both Colombian institutional investors and foreign investors will establish two parallel vehicles within the overall fund structure: a Colombian private equity fund and an offshore limited partnership structure (typically established in jurisdictions such as the Cayman Islands), that enter into a parallel investment agreement.

Foreign investors may take advantage of certain features of private equity funds such as (i) the fact that income tax withholding is only applied when there is a cash distributions and (ii) the fact that all distributions by the fund are first credited as a reimbursement of their equity investment and only when equity has been reimbursed in full the investor is deemed to be receiving profits, which may result in practice in deferred taxes.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Under current Colombian securities law, a public offer of securities must be registered with the National Securities Registry and approved by the SFC. The offer and sale of interests in a Colombian private equity fund will be deemed a public offer of securities if they are as follows:
- addressed to an undetermined number of persons;
- targeted at undetermined sectors or groups of entities or individuals; or
- made through any mass communications media with the purposes of selling, subscribing or acquiring securities.

Unless otherwise expressly set out in the fund's by-laws, Colombian private equity funds are automatically registered in the National Securities Registry, and therefore are 'pre-approved' for public offer and sale to all types of eligible investors.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Colombian law does not establish restrictions on the types of investors that may participate in private equity funds formed in Colombia. The fund's by-laws will often establish restrictions (eg, by only allowing professional investors) in an effort to avoid the heightened scrutiny from the SFC that would normally accompany a fund that is aimed at a broader universe of potential investors.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Colombian law requires ongoing filings with the SFC regarding the identity of investors in private equity funds.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

The public offering of interests in a Colombian private equity fund must be conducted through broker-dealers, which must be registered as such with the SFC.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The administrator of a Colombian private equity fund is responsible for adopting the rules and procedures for compliance with the SFC's system for the management or risks associated with money laundering and the financing of terrorism (SARLAFT), which is aimed at doing the following:
- preventing the use of the fund for purposes of money laundering and the financing of terrorism;
- ensuring that the fund follows international standards adopted by the International Financial Action Task Force; and
- avoiding the receipt of investments or contributions from, or relationships with, entities established in non-cooperating countries, as identified by the International Financial Action Task Force, the United States Department of the Treasury or other internationally recognised agencies.

SARLAFT requires, among other obligations, that the fund administrator request from investors all information required to identify themselves, their beneficial owners and the source of their assets, and that the fund administrator and the fund manager conduct due diligence to get to know the fund's counterparts and its targets. It also requires the fund's administrator to report any suspicious transactions.

The fund administrator and the fund manager are responsible for complying with such rules and procedures when discharging their duties with respect to the fund.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Unless otherwise expressly set out in the fund's by-laws, Colombian private equity funds are automatically registered in the National Securities Registry, and therefore are 'pre-approved' for public offer and sale to all types of eligible investors. Registration with the National Securities Registry entitles the fund to be listed on the Colombian stock exchange.

However, Colombian private equity funds are rarely (if ever) listed. This is probably because Colombian private equity funds are targeted at a small universe of potential investors (pension funds and other institutional investors) and the secondary market for these products is yet to develop.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As a matter of general principle, a listed fund would not be able to restrict transfers of membership interests to certain types of investors.

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Update and trends

The Financial Regulation Agency (URF) has published draft regulations that will provide regulation for private equity funds independent from other close-end or open-end portfolio investments.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Colombian private equity funds can only invest up to one-third of the investors' contributions in Colombian publicly listed securities.

A Colombian private equity fund cannot invest in assets, membership interests or securities when the owner, seller or issuer of which is a pension fund manager that is an investor in that fund. The same applies to any affiliate of such pension fund manager.

Because the tax treatment afforded to institutional investors and foreign investors is different (institutional investors are, generally, not subject to Colombian income tax, while foreign investors are) many Colombian fund managers targeting both Colombian institutional investors and foreign investors will establish two parallel vehicles within the overall fund structure: a Colombian private equity fund and an offshore limited partnership structure (typically established in jurisdictions such as a the Cayman Islands), that enter into a parallel investment agreement.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Other than for tax reasons (as described in question 21), generally there are no legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund.

From a practical perspective, because management fees are governed by market practice (currently around 2 per cent) and the Colombian private equity fund requires a fund administrator, the administrator's fees will usually 'bite into' the sponsors' management fees, so that the aggregate of both fees does not exceed the market fees.

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Croatia

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Private equity (PE) funds in Croatia may be formed as a collective investment scheme structured as a separate pool of assets (OIFRC) or funds structured as corporations, namely a joint-stock company or a limited liability company (ZIFRC). For taxation reasons all the currently existing PE funds are formed as OIFRCs.

OIFRCs are constituted and managed by an external Croatian alternative asset management company (UAIF). Assets in OIFRCs are separate for all purposes from the assets of their investors, the UAIF and any other assets managed by the same UAIF. UAIFs may be established in the form of a limited liability company or a joint-stock company.

ZIFRCs are managed by an internal UAIF, meaning that the form of a limited liability company or a joint- stock company serves both the purpose of fund and manager.

OIFRCs, ZIFRCs and UAIFs are subject to direct regulatory approval and supervision by the Croatian Financial Services Supervisory Agency (the Regulator).

Each of the above-mentioned legal vehicles also typically qualifies as an alternative investment fund (AIF) pursuant to Directive No. 2011/61/EC on Alternative Investment Fund Managers (the AIFMD), as reflected in the Croatian legal framework.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of an OIFRC or a ZIFRC requires the adoption of the fund rules or the articles of associations or by-laws of the relevant entity. It will also require a decision to appoint an external or internal manager and the approval of funds governing documents and the manager by the Regulator.

If an OIFRC is formed by an already licensed UAIF the process shall be relatively faster, as such fund requires the approval of only the funds documentation and not the manager.

As a ZIFRC is managed by an internal manager, which can manage only one such fund, the licensing procedure will be lengthier, as the Regulator will license both the fund and the internal manager at the same time.

The compliance requirements for both OIFRCs and ZIFRCs are checked by the Regulator and the usual filings for authorisation would comprise (but are not limited to) the following:

- investment strategy and type of fund;
- the funds documentation rules, prospectus, the statute and or instruments of incorporation where applicable;
- information about the risks associated with the fund;
- depositary arrangements; and
- evidence of the necessary organisational requirements.

Additionally, the application must also contain a proof of capital maintenance of the manager and other documentation requested by the Regulator.

The Regulator has a two-month period to decide on the application. It can always extend this period by asking for additional documentation, but in general the process of authorisation should not be longer than the prescribed two months or even less than that.

According to the AIFMD passport, Croatian-authorised managers may also carry out management activities in respect of EU PE funds, based on their home member state authorisation and vice versa.

If formed as an OIFRC a public notary is not required in the formation process of a PE fund. However, the formation of a ZIFRC or UAIF requires the assistance of a notary public and the relevant registration with the Croatian commercial court register, as they have corporate identities as limited liability or joint-stock companies.

The minimal capital requirements for an external UAIF is 2.4 million kuna and for internal UAIF 1 million kuna.

The approximate administration fee for establishing an external UAIF would amount to around 24,000 kuna and for an OIFRC or a ZIFRC around 19,000 kuna.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Croatian PE fund vehicles are registered in the register of funds and management companies, which is kept by the Regulator. As they are fully licensed by the Regulator they must abide by the organisational rules, thus keeping the registered office and books and records and regularly reporting to the Regulator.

UAIFs managing PE funds established in Croatia must have a registered seat either in Croatia or in another EU member state and are required to maintain a custodian that may be a credit institution having its registered seat in Croatia or a branch of an EU credit institution established in Croatia holding authorisation from the competent authority of that member state, or a branch of a non-EU credit institution established in Croatia holding authorisation of the Croatian National Bank.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

All information on the identity of investors, balance of units or payments and pay-offs is confidential and therefore it is not accessible to the public.

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5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

There are no circumstances under which a third-party-investor in a fund would be held liable under Croatian legislation. The Croatian Alternative Investments Funds Act generally prescribes that all transactions of a fund are concluded by the UAIF in its own name and for the account of the fund. Any legal relation that would result in a direct obligation of the investor is considered null and void.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

As all Croatian PE funds qualify as AIFs, the fiduciary duties set forth in the AIFMD also apply to Croatian AIF managers and those duties may not be modified or opted out of by contractual provisions between the parties. Under the Alternative Investment Funds Act, fund managers when performing their fiduciary duties are required as follows:

- to act honestly and fairly and in accordance with the rules of the profession and in the best interests of the AIFs and the investors of the AIFs they manage;
- to act with due professional care;
- to have and employ effectively the resources and procedures that are necessary for the proper performance of the business activities of the AIFM;
- to take all reasonable steps to avoid conflicts of interest and, where such conflicts cannot be avoided, identify, manage and monitor, and where applicable, disclose, those conflicts of interests in order to prevent them from adversely affecting the interests of the AIFs and their investors and to ensure that the investors and AIFs managed by the AIFM are fairly treated; and
- to comply with legal provisions so as to promote the best interests of the investors and the integrity of the capital market.

In general, a UAIF is liable to its investors pursuant to clauses in the Alternative Investment Funds Act, for the execution of the mandate entrusted to it and for any misconduct in the management of the corporate affairs of the managed investment fund. The fault of the UAIF is presumed and the burden of proof whether it has employed the care of a diligent and conscientious manager is on the UAIF. The standard of care applied is the standard of care of a professional manager acting with due care in a professional manner.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The concepts of gross negligence and of ordinary negligence standard of liability are recognised in Croatian law, but are not applicable to the standard of care for the management of a PE fund.

Namely, the fault of the management is presumed by law and it has the burden of proof to show that it has acted with full professional care. Thus the contractual application of a lower standard of care and the exclusion of ordinary negligence would be void.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are various restrictions depending on the type of PE vehicle. PE funds in Croatia are open only for professional investors and qualified investors in risk capital – see question 24.

The rules of the fund usually contain restrictions on transferability of interests and rights of first refusal. Regulations provide that the rules should contain at least the provisions that allow the investors to decide on the transfer of the fund to another manager, confirmation of the auditor of the fund and its financial statements and approval of the change of investment policies and strategies.

Redomiciling of foreign PE funds into Croatia would not be possible because the Alternative Investment Funds Act defines only OIFRCs and ZIFRCs as valid PE vehicles. In that sense the request for licensing in the form of an OIFRC and a ZIFRC should be filed. For EU members we do not see any sense in redomiciling as they can provide services in Croatia under the AIFMD European passport. Such a transfer is also feasible under a cross-border merger process.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Fund assets are separate from the assets and liabilities of the UAIF and as a result the bankruptcy, insolvency or similar events at the level of the UAIF shall not affect the fund and its assets.

The Alternative Investment Funds Act prescribes that the opening of the insolvency procedure in relation to a UAIF is a reason for revoking the licence of such a UAIF – meaning that in fact the investors will need to decide on a new UAIF to manage the fund or to initiate the liquidation process of the fund.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The national regulatory body for PE funds is the Regulator. In general, the Regulator:

- monitors the organisational conditions, strategies, policies and procedure of a UAIF and the funds;
- monitors and assesses the financial stability and standing of the supervised entity and the risks to which it is exposed; and
- supervises the legality of the UAIF's conduct.

The Regulator's supervision is both on and off site and the Regulator has the power to fine a UAIF and the managers personally, to order changes in organisation by an administrative act and finally to revoke the UAIF's licence as the most stringent measure.

The funds also have disclosure requirements. To start with, they issue fund rules and the annual financial report, which they report both to the Regulator and to the investors.

The annual accounts must be audited, and the auditor is approved by the investors.

Both an OIFRC and a ZIFRC also have the obligation to file half-yearly financial reports to the Regulator, and a valuation report to the depositary bank.

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11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

As stated in question 2, OIFRCs, ZIFRCs and UAIFs are subject to a licensing processes and are regularly supervised by the Regulator in accordance with Croatian and EU regulations.

OIFRC and ZIFRC rules and their amendments are pre-approved by the Regulator. UAIF articles of association and their organisational issues are also pre-authorised and supervised by the Regulator.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Under the Alternative Investment Funds Act, a UAIF should have at least two management board members and at least one management board member is required to obtain an investment adviser's licence.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The board of directors of a UAIF must have a minimum of two directors. The directors and officers of the UAIF must meet certain requirements regarding integrity and reputation. In this respect, they must complete a questionnaire required by the Regulator and present their plan of activities to the Regulator. The Regulator licenses the members of the management board for a five-year term and can refuse the licence application if they do not fulfil the legal requirements. In that sense the law requires at least three years' experience of governing positions in a UAIF or at least five years' experience in similar positions. The management board members should have a contract of employment with the UAIF with full working hours, and at least one of the members should know the Croatian language and have an investment adviser licence.

For the capital requirements of a UAIF see question 2.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no specific rules applicable to managers or advisers of PE funds.

The Financing of Political Parties Act regulates contributions to political parties. It prescribes that legal entities can donate up to 300,000 kuna per fiscal year and natural persons 30,000 kuna. The identity of the contributors is recorded by the political party and a list of contributors must be publicly available.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

As both OIFRCs and ZIFRCs are regulated as AIFs, the applicable rules under the AIFMD with respect to the marketing and distribution of AIFs are in place and should be complied with.

Other than those mentioned above, there are no specific rules governing the marketing of funds to public pension plans and other governmental entities.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no such rules in Croatia.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Where corporate income tax is concerned, the Croatian tax authorities see only an OIFRC as tax-transparent vehicle. On the other hand, a ZIFRC would be considered as a 'normal' company and thus subject to corporate income tax.

The tax treatment of distributions made by Croatian PE funds depends on their beneficiaries, namely whether they are domestic or foreign, individual or corporate investors.

Domestic individual investors
- Capital gains are subject to a withholding tax of 12 per cent; and
- dividends are subject to withholding tax of 12 per cent.

Domestic corporate investors
- Not subject to taxation of capital gains or dividends; and
- corporate income tax is set at 12 per cent for revenues below 3 million kuna and 18 per cent if revenues are equal or higher than 3 million kuna.

Foreign individual investors
- Capital gains are subject to a withholding tax of 12 per cent; and
- dividends are subject to withholding tax of 12 per cent.

Capital gains and dividends of non-residents are generally considered to have been obtained in Croatia for tax purposes and consequently are subject to taxation in Croatia, unless there is a double tax treaty in force.

Foreign corporate investors
- Dividends are subject to withholding tax of 12 per cent with the exemption for foreign investors that are corporations resident in an EU member state and subject to double tax treaties in force.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

See question 17.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Under the Croatian tax regime it is not necessary to confirm a ruling that a Croatian PE fund will be treated as such for tax purposes. This arises from the opinion of the Croatian tax authorities, which treat only an OIFRC as a tax-transparent vehicle and consider a ZIFRC as an ordinary corporate entity.

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Investors that are Croatian residents are subject to ordinary income taxes as described in question 17.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

No. See question 2 regarding the registration fees prescribed by the Regulator.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

A UAIF is liable to corporate income tax on its overall income, regardless of its source. Management fees, the depositary bank fee and the Regulator prescribed fees are VAT-exempt. If received, carried interest would be subject to standard corporate income tax.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Croatia currently has double tax treaties in force with the following countries: Albania, Armenia, Austria, Azerbaijan, Belgium, Belarus, Bosnia and Herzegovina, Bulgaria, Canada, Chile, China, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jordan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Moldova, Morocco, the Netherlands, Norway, Oman, Poland, Portugal, Qatar, Romania, Russia, San Marino, Serbia, Slovakia, Slovenia, South Africa, Sweden, Switzerland, Syria, Turkey, Turkmenistan, Ukraine and the United Kingdom.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

No.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Both OIFRCs and ZIFRCs can be offered only through private placement. As such the offer will fall outside the scope of the Prospectus Directive.

Interests may only be offered to professional investors in the sense of the MiFID definition and to qualified investors in risk capital.

Qualified investors in risk capital are those who are investing a minimum of 2 million kuna as a one-time payment, whose total assets amount to 10 million kuna or more and who have sufficient experience and professional knowledge to understand the risks involved. Also, a UAIF, its manager or any other persons involved in the management are considered to be qualified as well.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Other than already mentioned in question 24, there are no additional restrictions on the types of investors that may participate in PE funds.

Update and trends

We have seen the development of the PE market with the initiation of a governmental public/private investment mechanism inaugurated in 2011, by which the government matched private investor interest in investing in PE funds with 1 billion kuna. The governmental programme has had a huge impact on the development of the PE market. We are now seeing some new domestic PE initiatives, which involve domestic pension funds and EIF, EIB and EBRD as investors. The structures will probably involve management companies licensed by a Croatian regulator, which will manage Dutch or Luxembourg-based funds.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

There are no requirements regarding notifications to the Regulator on the identity of investors in PE funds. However, the Regulator can always request information on their identity.

As for changes in the management, notice to the Regulator must be given and its pre-approval obtained with respect to the following:

- any changes in the UAIF caused by mergers, acquisitions, divisions and consolidations of the UAIF;
- any changes in the shareholding of the UAIF when the share of voting rights or capital held directly or indirectly by a person is increased or reduced above or beyond 20, 30 or 50 per cent; and
- the transfer of management activities to another UAIF.

Additionally, the UAIF has the obligation to submit to the Regulator once a year a list of all the shareholders with the percentage of their capital and voting rights in the UAIF.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Marketing units in a PE fund may be performed by UAIFs or other legal persons in Croatia under a business cooperation agreement, both of which must obtain a permission to perform such activities.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Implementation of the new Anti-Money Laundering Act in Croatia began on 1 January 2018. The provisions of the act, which implements the provisions of the relevant EU Anti-Money Laundering Directives, also apply to UAIFs. Consequently, a UAIF must comply with enhanced customer due diligence requirements to identify the investors in the fund and their beneficial owners, as well as to ensure continuous monitoring of business relationships of the investors, including transaction control. UAIFs also have the obligation to keep records on investors, business relationships and transactions.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

There has not been any listing of PE funds in Croatia.

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Such listing would only be possible in the case of a ZIFRC, but even in this situation it is doubtful whether the Zagreb securities exchange would allow such a listing, since interests in the ZIFRC could only be sold to qualified PE investors.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

See question 29.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

On a general basis such restrictions are mostly self-imposed by the rules or prospectus of the fund itself.

Being a part of the AIFMD environment, all restrictions arising from the AIFMD will also apply in the Croatian legal environment (such as the case may be with the use of leverage and the acquisition of control over non-listed companies and issuers).

The Croatian by-law on the types of AIF prescribes basic restrictions for PE funds:

- the minimal number of transactions and the investment period should be defined in the rules of the fund;
- at least 70 per cent of the assets should be invested in equity or equity-like instruments; and
- use of leverage is allowed only if such a use is explicitly explained in the rules of the fund.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Compensation and profit-sharing arrangements are restricted within the AIFMD environment. As already noted, UAIFs are AIFMD-regulated and thus the remuneration policies should be consistent with AIFMD and the EU Securities Market Authority guidelines in relation to principles of remuneration.

In line with this approach the Alternative Investment Funds Act prescribes the obligation to install and keep appropriate remuneration policies in place. Such policies should be consistent with the size of the UAIF and the funds and include measures for avoiding conflicts of interest. The management board must review them at least once a year. The UAIF may award rewards to employees, board members and the supervisory board only if they are sustainable and justified. In the case of negative business performance, UAIFs must take it into account when considering the awards. In addition, a UAIF's annual financial statements must disclose the total amount of bonuses and prizes and the number of recipients of such bonuses and prizes.

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Differentiation must be made between non-regulated private equity (PE) vehicles and regulated PE vehicles. The former are only based on and limited by corporate law provisions; common legal forms are corporations in the form of a limited liability company (GmbH) and partnership structures consisting of a general partner (GP) and one or several limited partners (LP).

If the German-domiciled PE vehicle is an alternative investment fund (AIF), the PE vehicle and its manager (the alternative investment fund manager (AIFM)) are subject to the rules and limitations of the German Capital Investment Code (KAGB). An AIF is any collective investment undertaking, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and which does not require authorisation pursuant to the EU Undertakings for Collective Investments in Transferable Securities (UCITS) Directive. In particular, in the case of club deals and joint-venture structures, but also in other cases, there are possibilities of avoiding qualification as an AIF, which might be useful in some cases; however, more and more institutional investors see the benefits of regulated structures (investor protection, internal guidelines to invest in regulated structures, standardisation of documentation), which is why regulated structures are becoming increasingly important.

As the KAGB came into force and effect, the legal formats for such regulated funds have been further regulated. AIFs can only take the legal forms defined in the KAGB for the relevant class of AIF (see below), in particular differentiating between open-end and closed-end AIFs and further differentiating between special AIFs (eligible only for investments by professional clients in terms of the AIFM Directive (AIFMD) and semi-professional clients as defined in the KAGB), and mutual funds, also eligible for investment by retail clients. The typical regulated PE vehicle is a closed-end special AIF in the form of an investment partnership (InvKG, typically established as a GmbH & Co InvKG) (ie, a closed-end LP structure (investment partnership) for professional clients). A GmbH cannot be used for this kind of regulated vehicle (except where the AIFM of the vehicle is only a 'registered AIFM' and not a fully regulated one, see article 3(2) AIFMD).

Potential legal forms

Only the following legal forms are eligible, if the vehicle is an AIF (subject to special rules for registered AIFM): it may be organised as an investment corporation (InvestAG), investment partnership (InvKG) or as a special form of separate asset investment fund – the latter form is always an open-end contractual vehicle that can only to a very limited extent invest in target companies and, hence, is not used for PE-vehicle purposes.

Open-end versus closed-end

An AIF is open-ended if its shares or units, at the request of any of its shareholders or unitholders, are repurchased or redeemed prior to the commencement of its liquidation phase or wind-down, directly or indirectly, out of the assets of the AIF and in accordance with the procedures and frequency set out in its rules or articles of incorporation, prospectus or offering documents. A closed-ended AIF is an AIF other than of the type previously described (ie, 'redemption' will only take place when the AIF is liquidated).

Furthermore, the KAGB and its purpose primarily addresses the AIFM rather than the AIF. An AIF can be externally managed (ie, the PE vehicle appoints an AIFM that manages the assets of the AIF), or internally managed, in which case the AIF itself is also its AIFM. In the latter case, if the AIF/AIFM is established as an InvKG, the GP will become the decisive regulated entity as the GP represents the InvKG based on corporate law rules.

An InvKG has its own legal personality and therefore is treated as an incorporated enterprise in legal terms. As a consequence, the partnership itself holds its assets and can assume its own liabilities.

From a practical standpoint and an investor's tax perspective, the GmbH & Co KG (limited partnership – unregulated) or InvKG (regulated) still prevails. Investors thereby subscribe for limited partnership interests and thus become LPs. The GmbH & Co KG/InvKG allows investors to combine the advantages of these legal forms. In particular, the personal liability of the investor can be (and in the case of regulated structures must be) limited to his or her liability contribution. Also, the limited partnership agreement under which the limited partnership was established does not have to be revealed to the public (except where it is a mutual AIF open for investment by retail clients) and, in particular, does not have to be filed in the respective German commercial register (in case of regulated structures, the German Financial Supervisory Authority (BaFin) must be informed and provided with the fund documentation). In addition, investors as LPs only have limited information rights compared with other legal forms. Because of the German tax system, such a limited partnership should be structured as a mere asset-managing partnership that fulfils certain requirements with regard to its investment strategy. Furthermore, such a limited partnership must not be qualified as a deemed trading partnership, despite its mere asset-managing activities. A qualification as a deemed trading partnership can be avoided if an LP is granted managing authority besides the sole GP (and the AIFM) being usually a limited liability company (GmbH). This is different from a typical limited partnership. The main characteristics of a mere asset-managing limited partnership have been defined in a Decree of the Federal Ministry of Finance of Germany (see questions 17 and 18).

Since German law does not require a minimum liability amount in general, usually only a very small part of the actual capital commitment of an LP is in fact registered with the commercial register and thus revealed to the public. According to German law, once an LP has fulfilled its obligation up to the respective liability amount and this has not been paid back in the meantime, the LP does not assume any further personal responsibility for liabilities of the partnership in relation to third parties (this is also ensured in the KAGB in the case of regulated structures). In contrast to LPs, a GP can be held liable for all debts and obligations of the partnership without any possible limitation. Owing to that legal restriction, funds are usually established as limited partnerships with

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the above-mentioned particularity, whereas the sole GP is a company organised as a limited liability company (GmbH). The actual liability of the GP can be limited to the assets of this limited liability company, and thus the shareholder of the limited liability company does not face any further personal liability. Although the liability of the GP is, from a practical standpoint, limited to a minimum, German law accepts such construction still as a limited partnership once duly established and organised, with the consequence that such limited partnership can benefit from the above-mentioned legal and tax advantages and is also an eligible structure for regulated AIFs.

There are no specific legal consequences for the management of a limited partnership compared with 'normal' limited partnerships under corporate law rules. Under German corporate law, a limited partnership is represented by a GP. If the GP is a limited liability company (GmbH), the management of the limited liability company representing the aforementioned company is thereby the management of the limited partnership. Such management is bound by typical legal obligations, such as the duty to file for insolvency if appropriate and, of course, to act towards the represented partnership with the appropriate standard of care as a prudent business manager. Within the respective employment agreements, additional regulations and duties can also be stipulated. In the case of regulated vehicles asset management power is transferred to the AIFM (which is the GP in the case of internally managed AIFs and a third party in the case of externally managed AIFs).

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of a limited partnership under German corporate law is straightforward. It takes place through the execution of an agreement between the GP and the LP(s). Upon execution of such a contract, the limited partnership comes into existence.

In the case of AIFs, an AIFM must be appointed (externally managed AIF) or established (internally managed AIF); in the latter case the AIF/AIFM must apply for a licence based on the rules of the KAGB. Since it is not easy to obtain such a licence and may take several months, and bearing in mind that an internally managed AIF is quite limited in servicing third parties, such internally managed structures are not very common. Rather, the GP of the InvKG appoints a third party that holds an appropriate licence and manages the AIF ('rent an AIFM' – Master-ManCo structures).

In order for the LPs to obtain the legal benefit of limited liability, registration of the partnership, its partners and the liability amounts with the commercial register is required. Notarisation is not required in this foundation process, but if the GP is a limited liability company and no shelf company has been used, the formation of this limited liability company requires proper notarisation.

The registration process of the limited partnership under corporate law is as follows:

- the above-mentioned filings have to be made with the local commercial register, which is located at the local court of the partnership's statutory seat; and
- the respective form must be signed for and on behalf of the LPs as well as the GP. These signatures need to be notarially certified, although notarisation of the relevant documents is not necessary. If legal entities are involved in the formation process, in particular as a GP or LP of the formed limited partnership, their valid existence and their due representation needs to be proved by the signatories.

An additional filing of the partnership agreement (for example, in the commercial register) is not required under corporate law. The expenses and fees for a common formation process usually amount to a maximum of €3,000.

Any change in the registered information during the course of the operation of the limited partnership must be filed at the commercial register in the appropriate form. In particular, a change in the structure of the shareholders (for example, through the entry or exit of LPs and an increase or decrease of liability amounts for LPs) must be registered at the commercial register. In addition, the partnership and GP are obliged to pay a fee to the Chamber of Industry and Commerce to draft and file annual financial statements at the commercial register and to publish them in the Electronic Federal Gazette. Finally, an annual tax return needs to be filed.

The registration of an AIF/AIFM with the BaFin depends on the type of AIF (ie, special AIF versus mutual AIF; internally managed versus externally managed; distribution activity or not). The KAGB sets out various requirements for the registration of the AIF/AIFM, which also affect the formation process (see questions 11 to 13).

Unlike in other jurisdictions, the engagement of service providers during the filing or formation process (or both) is quite rare, except for AIFs/AIFMs, in which case law firms are frequently used for the fund documentation, registration and licence topics (if any). Usually, the notary public engaged with the certification process is also instructed to prepare the respective filings at the commercial registry. In addition to this, lawyers and tax advisers usually assist investors and initiators within this process.

As mentioned, one major advantage of the limited partnership over other legal forms is the fact that there are practically no minimum capital requirements relating to liability amounts of the LPs (except where the LP is an internally managed AIF, in which case there is a minimum capital of €300,000 plus a premium if the volume is above €250 million and subject to minimum capital requirements as set out in article 9(5) AIFMD). If, like many private equity funds, the limited liability company is set up as a GmbH & Co KG, under corporate law it must comply with a minimum capital requirement; in particular, it has to be vested with a minimum registered capital of €25,000. Notwithstanding the fact that German law has recently introduced a corporate legal entity that is similar to the limited liability company but that has a minimum capital requirement of only €1, so far there has been no practical adoption of such legal form for private equity funds (and is untested with BaFin for the purposes of InvKGs). For this new legal form German law requires (in return for the privilege of not meeting the initial minimum capital requirement of other fund forms) that the earnings of this legal entity are retained until the 'normal' capital requirement of €25,000 is reached.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Any limited partnership has to maintain an administrative office and disclose its location via a respective registration with the commercial register. Under the German Commercial Code, a limited partnership also has a legal duty to keep proper books and business records at all times. A corporate secretary, which is common in other jurisdictions, is not necessary, and is besides that not feasible to formally implement under German law. Although it is not required to maintain a custodian for a non-regulated AIF or an administrator locally, foreign investors in particular tend to hire tax advisers to draft and prepare, according to the German legal requirements, books, records and filings with the authorities and thus enable the management of the limited partnership to fulfil its legal obligations. It is not, however, possible to delegate the respective legal duties of the management to third parties, in particular to advisers or professional administrators.

Additionally, the KAGB requires AIFMs to maintain a statutory place of business. For each AIF that is not only registered but 'fully supervised' a custodian must be appointed (either by the AIFM or the AIF – responsibilities are agreed upon in the appointment agreement). In contrast to, for example, Luxembourg fund structures, the functions of an administrator are performed by the AIFM or the AIF itself.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Generally, the common source of information for third parties about a private equity fund formed as a limited partnership is the commercial register and, with regard to an AIF, the prospectus for mutual AIFs, which is disclosed on the BaFin website. In the case of a special AIF there is also a prospectus-like document, the section 307-document (which refers to the main section in the KAGB establishing the information requirement in relation to (potential) investors) or information

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document. Such information document is not disclosed to the public but only provided to (potential) investors. It has a minimum content covering, inter alia, risks, costs, valuation, structure, investment guidelines, leverage limitations, conflicts of interest and third parties involved (see article 23 AIFMD).

Any record filed at the commercial register is accessible by the public without limitation. Therefore, the identity of the investors – in the event that they hold their interests as LPs – and the amount of their liability are generally public. If the disclosure of the identity of the investors is to be avoided, it is possible to design a limited partnership with nominees as direct LPs holding and managing their LP interests for the 'real' investors (the appointment of such a trustee is not allowed in the case of a closed-end special AIF, which is, however, not an issue in practice as typically there are only a few investors in such special AIFs).

The limited partnership itself has to file its annual statements with both the commercial register and the Federal Gazette (and needs to comply with reporting obligations in relation to BaFin in the case of an AIF). Besides that, no other financial statement of the limited partnership needs to be revealed to the public. The information can be accessed by third parties by way of formal application to the commercial register or by access to online registries. The Federal Gazette also offers online access for any third party without the requirement of stating the reasons for the request.

The partnership agreement is not registered with the commercial register and therefore is not accessible to third parties (except in the case of mutual AIFs, where the prospectus is available on the BaFin website). In contrast, the articles of association of the GP, if established as a limited liability company, are filed with the commercial register and are thus subject to public access. This is, however, not crucial in most cases, since the articles of association of the GP do not contain significant regulations or commercial terms but are instead typically standard agreements (even in the case of an AIF).

In the event that the above-mentioned obligations of the management of the limited partnership are not met, the commercial register is in a position to impose fines.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

First, the limited liability of a third-party investor as regards its legal formation under foreign law will generally be accepted under local law as well. In particular, if a foreign investor established under foreign law invests in a German private equity fund, there are no implications for the limited liability granted to the shareholders of the foreign investor.

In addition, once the private equity fund vehicle itself is duly and properly established as a GmbH & Co KG, the limited liability of the LPs is also assured. For AIFs in that legal form this is not only ensured by corporate law provisions but also by the rules of the KAGB.

This means that, as long as a foreign investor enters into a German limited partnership that has been established in accordance with German law, and as long as its entry is also executed in accordance with German law, its personal liability is limited – in the event that it enters as an LP – to the liability amount registered with the commercial register. Once this registered amount has been paid in entirely and has not been paid back, there is no additional liability of the investor towards third parties. Apart from that, there is also a risk for an investor within the time frame between its factual entry into the limited partnership and its registration as an LP with the commercial register. In particular, German law construes for that time frame that an LP shall be deemed as a GP and thus shall be held personally liable without any restrictions as long as its status as an LP has not yet been registered with the commercial register. To avoid such risk it is crucial that the entry is designed in a way that the investor shall only be accepted as LP once the registration with the commercial register has been performed. Furthermore, it is to be avoided (also based on KAGB rules) that the AIF becomes operatively active before the investors are properly on board.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Generally, a fund manager owes a fiduciary duty to the limited partnership to act only in the best interest of the partnership itself (with the attention of a diligent business person) and not in the interest of one or more specific partners. The intensity of such duty depends on various different factors and in particular on the structure of the limited partnership in general, as well as of applicable KAGB rules in the case of an AIF. The manager of the limited partnership/AIF also needs to treat all LPs equally and thus also owes a fiduciary duty to the partners in a body. In rare and exceptional cases this can even lead to a personal claim of one or more partners against the management directly.

The fund manager also owes the fiduciary obligation and preservation of interest to the investors and to the integrity of the market pursuant to the rules of the KAGB.

Although it is generally possible to modify the aforementioned duties (except the regulatory ones based on the KAGB, which are not negotiable) or even to exclude liability for certain duties in favour of the management, such limitation is only possible to the amount where the core area of the fiduciary duty is not affected. Since the fiduciary duty is a basic ground rule of German corporate law, German case law tends to interpret modifications or even exclusions of such fiduciary duties very strictly and instead of protecting the interests of the limited partnership and LPs; regulatory law provisions are even stricter.

Besides the general fiduciary duties, which are, to some extent, subject to interpretation and modification, there are also some explicitly defined duties of the management. For example, the management has to grant access to the books and accounts of the partnership and to relevant information affecting the possibility to evaluate the accuracy of the accounts for the LPs. Such right generally ends with the resignation as an LP. However, German case law still grants a right of the former LP to request respective information as long as a time frame is concerned in which he or she was partner of the partnership, and to the extent that he or she depends on the requested information in order to evaluate potential claims against other partners or the partnership. These rights may not be restricted.

Apart from that, the KAGB stipulates certain supervisory duties for the AIFM (see question 13).

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

German law does not recognise a 'gross negligence' standard of liability applicable to the management of a private equity fund. Under German law, the management must apply the standard of care of a prudent businessperson, and such standard is generally even higher than an 'ordinary negligence' standard. This standard also applies for limited partnerships formed as a vehicle for private equity funds. From a practical standpoint, private equity funds often try to modify this standard by agreements within the partnership, or in particular with the relevant management, setting out a gross negligence standard in favour of the management. As a matter of law, such lower standard can, however, only affect potential claims between the partnership and the management, between the partners and the management, or both. Third parties that are not part of such agreement are generally not affected thereby.

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8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

AIFs are subject to the KAGB. Depending on whether the AIF is externally or internally managed, there are notification obligations in relation to BaFin, including in the case of redomiciling. AIFs can only be established in eligible legal forms, which limits conversion into other legal forms.

In addition, if a limited partnership is used as a private equity vehicle and the relevant partnership agreement does not state otherwise, it is, under corporate law, only possible to transfer a partnership interest with the consent of all partners (except for certain institutional investors that require free transferability). Since this is a very high hurdle, most of the private equity funds established under German law in the form of a limited partnership implement regulations within the partnership agreement according to which such transfer shall be possible provided that the GP consents (again, except for certain institutional investors that require free transferability).

As to a redomiciling of limited partnerships formed in other jurisdictions into Germany, such redomiciling without a conversion is only possible for such legal entities formed under the laws of an EU member state or under the laws of a country that has bilateral agreements with Germany (or both) stipulating the acceptance of foreign legal formats in Germany as well. Apart from that, such redomiciling demands a conversion of the foreign legal format into a German legal format. Usually, such conversion requires a total re-establishment of the foreign partnership under German law, since the foreign legal form agreement does not comply with German legal standards, including KAGB limitations as applicable for AIFs.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Regulatory implications do not occur arising out of a bankruptcy, insolvency, change of control, restructuring or a similar transaction of a private equity fund's sponsor. However, such events might, of course, trigger consequences explicitly concerted by the parties themselves within the shareholders' agreement and other agreements.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The BaFin is the competent supervisory authority, provided with access to all information and certain intervention rights against the AIFM, such as the right to withdraw the AIFM's licence to operate, to dismiss the AIFM's management, to prohibit or restrict profit distribution in case of a lack of equity, to restrict leverage and even the right to take 'appropriate measures' to protect the AIFM's debtors and investors into the AIF. The AIFM is, on the other hand, obliged to inform the BaFin comprehensively, for example, about relevant changes within the AIFM, in particular regarding information relevant to its licence to operate, the markets and instruments in which the AIFM invests and material investments of the managed AIFs. The AIFM must further provide its financial statements, annual reports and its audit reports to the BaFin.

Finally, the KAGB also stipulates restrictions to private equity transactions. The AIFM, acting on behalf of an AIF, is, for example, obliged to promptly notify the BaFin when reaching, exceeding or falling below a threshold of 10, 20, 30, 50 and 75 per cent in the voting rights of a non-listed company held or to be acquired for an AIF. When obtaining control over such a non-listed company by reaching 50 per cent or more of the voting rights, various information duties are further triggered towards the company itself as well as towards its shareholders. Moreover, various additional requirements, for example, to inform and cooperate with the companies' employees, have also been established. The KAGB further prevents private equity funds in particular from asset stripping. Thus profit distribution, capital reduction and the purchase of own shares is restricted within the first 24 months after obtaining control over the company. The KAGB only provides for exemptions from the aforementioned restrictions concerning target companies that have fewer than 250 employees, a yearly turnover below €50 million, where the total assets are below €43 million or where the target company is a real estate special purpose vehicle.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

An AIF itself is generally not subject to governmental approval, licensing or registration as long as it is externally managed. However, an AIFM (which is the GP in the case of internally managed AIF in the form of an InvKG) has to comply with various regulations and licence requirements in this regard (see questions 12 and 13) and a particular kind of prospectus must be filed with BaFin (full prospectus for mutual AIF, section 307 document for special AIF). According to the KAGB, any fund now requires a depositary (except AIFs/AIFMs that are registered only (sub-threshold AIF/AIFMs)). This depositary shall have a supervisory function and shall further control the fund's assets for the benefit of the investors.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Before the KAGB was introduced, a private equity fund's manager (or any of his or her officers, directors or control persons) was not required to register as an investment adviser in Germany; this has not been changed. However, the AIFM must file for a licence that also covers a review of the CVs of its proposed directors, etc.

The KAGB sets out various requirements for the registration of private equity fund managers in the context of licensing the AIFM and thereafter whenever a director of the AIFM shall be replaced. Pure advisers are subject to the German Banking Act (KWG) licence requirements depending on the type of advice they provide (ie, if they advise in financial instruments); advice in relation to real assets are not subject to such licence (but may be subject to a registration under the provisions of the Industrial Code). In particular, and depending on the size of the AIF and the type of its investors, a manager either requires a licence to manage a fund issued by the BaFin or at least a registration. Without such, the manager is not allowed to act as AIFM. The application needs to contain information, for example, as to the managing directors (at least two are required), their qualifications, the domestic place of business, the articles of association, the business plan, the principles for enumeration, the investment strategy with its risk profile and information as to the amount of leverage used.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

According to the KAGB, the director acting for the AIFM shall be of good repute and expertise (this is normally the case if there is sufficient experience with regard to the managed asset and risk exposures and provided that there are no relevant criminal records). Moreover, the AIFM

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shall, for example, implement adequate risk management, including liquidity management, controlling as well as precautionary measures to prevent conflicts of interest, which requires the establishment of a compliance function. Also the KAGB requires certain organisational and reporting procedures some of which go beyond the AIFMD rules.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such rules in Germany applying to private equity fund's managers or investment advisers, or even to their employees. However, the recipient of relevant payments may be obliged to disclose any monies received.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no such rules under German law.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no rules limiting banks from investing in or sponsoring private equity funds emerging from the 2008 or the recent financial crisis. However, depending on the risk of the fund, banks may have to allocate quite high own-fund requirements based on the Capital Requirements Directive IV rules.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

In November 2013, the German parliament passed the Act on the Adaption of Investment Fund Taxation (Investment Fund Taxation Act) which has, in general, come into force in December 2013. In general, private equity fund vehicles are formed as limited partnerships (eg, GmbH & Co KG). According to the Investment Fund Taxation Act, for limited partnerships the general rules of taxation remain applicable, namely there are no changes to the taxation rules currently in force. Generally, a private equity fund vehicle in the form of a limited partnership that is treated as tax-transparent for income tax purposes would not itself be subject to income tax, but its partners would be subject. However, a limited partnership resident in Germany that is a (deemed or actual) trading partnership is subject to trade tax (a kind of municipality tax in Germany). This can, however, be avoided, if:

(i) the limited partnership qualifies as a mere asset-managing partnership that is not engaged in any trade or business for German tax purposes; and
(ii) at least one partner with managing authority is not a GP being a company (see (i)); in practice, usually an LP is granted managing authority besides the sole GP being a company.

If these preconditions are fulfilled, the limited partnership is not subject to trade tax in Germany either. The fund itself will also not be required to withhold taxes with respect to the partner's individual share of income or gains.

The main characteristics of a mere asset-managing limited partnership have been defined in a decree of the Federal Ministry of Finance and limit the limited partnership's investment strategies (eg, no leverage on level of the partnership, no active management of the fund exceeding the typical asset management, no short-term investments, no active management of the portfolio companies, no offer to the public with respect to the interest participation in the fund, no re-investment of sales gains, no direct investment into a (deemed) trading partnership by the limited partnership being the private equity fund).

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Generally, non-resident investors in a private equity fund structured as a mere asset-managing limited partnership that does not qualify as a deemed trading partnership will be subject to taxes in Germany pursuant to the general rules for non-residents, namely, the non-resident investors might be subject to German withholding tax, for example, with respect to dividend distributions of the portfolio companies held by the private equity fund or a German tax assessment that requires that the non-resident investor files an income tax return with the responsible German tax office. The latter might be necessary, if the capital gain is triggered by way of a sale of a company resident in Germany and held directly by the private equity fund structured as a limited partnership. Please note, however, that the domestic German tax rules might be overruled by the provisions of double taxation treaties or EU directives, if applicable. If so, a refund because of an exemption from or reduction in withholding taxes may depend on certain filing procedures being fulfilled in time.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, it is desirable to obtain a binding ruling from local tax authorities in order to ensure that the adequately structured fund vehicle will comply with the tax criteria of a mere asset-managing limited partnership. Since the criteria of a mere asset-managing limited partnership are not always clear or cannot be met easily, these issues should be clarified beforehand. If the fund is not able to comply with these criteria (for example, owing to its investment strategy), the fund will be qualified as a trading partnership, which, under the assumption of having an office in Germany, would be subject to German trade tax, if and insofar as this office could be qualified as a permanent establishment of the private equity fund in Germany.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant taxes associated with the organisation of a private equity fund in Germany; in particular, Germany does not have stamp duty.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Forty per cent of the carried interest for a private equity fund's sponsor could, if certain prerequisites are fulfilled, be exempt from income tax, if understood, in particular, that this carried interest is paid to the sponsor only after the investors and LPs respectively have been fully paid back their individually invested amounts, and in the case of a sponsor not being resident in Germany, the management services having been

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rendered in Germany or if they could be allocated with a permanent establishment of the private equity fund in Germany. The remaining 60 per cent is still subject to the applicable income tax rate. Note that this specific tax privilege only applies if the fund vehicle qualifies as a mere asset-managing partnership that does not qualify as a deemed trading partnership. For other fund structures, such as companies or security funds, it is not clear whether privileged capital gains taxation would apply under general rules.

The management fee payable to the managing partner of a fund is subject to German VAT because the German tax authorities qualify the management fee as a fee for services. This applies irrespective of whether the management fee is structured as a priority profit share.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Germany has a very good network of double taxation treaties with most OECD member states and many other countries in the world. Usually, the double taxation treaties apply directly to the partners of the fund if the fund is structured as a tax transparent partnership without any permanent establishment. However, it needs to be checked carefully in each individual case whether a double taxation treaty applies to the fund vehicle being a partnership or its partners as this depends on the terms of the specific double taxation treaty and the relevant facts of the structure.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

German tax rules are very complex and constantly subject to significant changes. Therefore, the tax structuring of both the formation of a private equity fund and the underlying fund investments requires diligent tax advice. Consultation with tax advisers with regard to the specific transactions and tax issues is highly recommended.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Before the KAGB came into force there were no such legal restrictions as long as interests in private equity funds were marketed to investors through private and not public placements. With the implementation of the KAGB, specific notification procedures with the BaFin for the marketing of interests in such funds were introduced. The KAGB thereby distinguishes between open-end and closed-end AIFs, the type of investors and the kind of investment asset pools. For example, there are special AIFs that can only be marketed to professional and semi-professional investors, and there are mutual AIFs that may also be marketed to private investors. Professional investors in particular comprise banks, investment firms, certain financial institutions, insurance companies, pension funds, companies of a certain size, national governments, etc. Semi-professional investors, in particular, comprise investors investing more than €200,000 and having a certain experience level, investors with a lower experience level but investing more than €10 million as well as senior management of the AIFM itself. Depending on the classification of the fund, the respective notification procedure varies.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Certain regulated companies (for example, insurance companies) have further restrictions regarding investments in private equity funds. On 7 March 2015, the amended German Investment Regulation and the German Pension Fund Capital Investment Regulation came into force. Their key aspect is to adapt the investment rules for restricted assets applied by German professional pension schemes and certain German pension plans to the regulatory framework under the AIFM Directive, as transposed into the KAGB. Insurance companies do not have to comply with these rules any longer but are generally subject to Solvency II Directive requirements. In practice, however, most insurance companies still use the old rules in parallel with the directive as long as their internal procedures have not been fully updated.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

According to section 34 of the KAGB, an AIFM is now required to disclose information to BaFin with respect to certain shareholders holding at least 10 per cent of the share capital or the voting rights in the AIFM. Such disclosure is not only necessary when obtaining a licence to operate but also in case the structure of such ownership changes. Furthermore, for AIFMs there are annual reporting obligations with regard to the managed AIF, which include abstract investor information (Annex 4 of Regulation No. 231/2013), as follows:

- to specify the approximate percentage of the AIF's equity that is beneficially owned by the five beneficial owners that have the largest equity interest in the AIF (as a percentage of outstanding units/shares of the AIF; look-through to the beneficial owners where known or possible);
- a breakdown of investor concentration by status of investors (estimate, if no precise information is available);
- listing professional clients (as defined in the Markets in Financial Instruments Directive 2004/39/EC as amended by Directive 2014/65/EU (MiFID II)); and
- listing retail investors.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Section 34f of the Industrial Code and section 32 KWG respectively set out specific licence or registration requirements for the persons offering interests in private equity funds.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Under German law there are no specific rules for private equity funds regarding money laundering. Nevertheless, private equity funds and their managers need to obey the rules of the German Anti-Money Laundering Act (in particular, the investor's identity needs to be confirmed).

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds in Germany are, with only very rare exceptions, not organised as stock corporations and thus are not listed on German stock exchanges.

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30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

According to German listing rules, it is not possible to effectively restrict the transfer of securities and therefore to restrict the transfer of the interest in a private equity fund.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Basically, funds formed under German law are not subject to any legal or regulatory restrictions affecting their participation in private equity transactions or affecting the structuring of private equity transactions completed inside or outside of Germany. There are only few exceptions regarding certain regulated markets as well as the limitation defined in the KAGB, for example, no asset stripping for some time after the acquisition of the target company.

Foreign private equity funds might, however, have to observe the latest changes in the German Foreign Trade Act. According to this, the Federal Ministry of Foreign Affairs can prohibit the acquisition of a significant interest in a domestic target if this could lead to public endangerment. From a practical point of view, this only applies to very sensitive sectors. Therefore, most private equity funds will not be affected by this law.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

According to the KAGB, the AIFM is now obliged to establish and disclose its principles for enumeration (see question 12). Such principles need to be in line with AIFM's risk management system and may, thus, indirectly affect the ability to take management fees, transaction fees and carried interest as it shall not incentivise taking risks outside the risk profile of the AIFM.

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Indonesia

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Currently private equity funds are not specifically regulated; private equity funds are set up outside Indonesia and then subsequently invested in the Indonesian portfolio or target company (which may be an operating company, holding company or listed company). Offshore private equity funds sometimes set up a limited liability company (PT) in Indonesia or a representative office to ease and support their efforts to find lucrative deals, or to act as a liaison office or for monitoring their portfolio.

A PT as a portfolio or target company can be in the form of a privately owned or publicly listed company. Law No. 40 of 2007 regarding Limited Liability Company (the Company Law) defines a PT as a legal entity that forms a partnership of capital, established by an agreement, performs business activities with all of its authorised capital divided into shares and fulfils the requirements as provided for in the Company Law and its ancillary regulations. It means PT has a legal entity and recognises the separation assets and liabilities between the shareholders and PT. As a consequence, shareholders and management boards (ie, the board of directors) of PTs shall not be personally liable for a binding agreement entered into in the name of the PT and, specifically for shareholders, they shall not be liable for PTs' losses extending beyond the value of shares he or she owns. However, to a certain extent, the shareholders or board of directors may be assumed liable for any loss within the PT if they have conducted activities in bad faith or have violated their fiduciary duty.

For certain investments, private equity may invest via discretionary funds in the form of mutual funds or venture capital or through portfolio investment on the Indonesian stock exchange in order to manage the restrictions on foreign ownership under the negative list regulation.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

As it is not specifically regulated, a private equity fund is normally formed outside Indonesia. The fund subsequently may form a PT in Indonesia to support its investments in the country.

In brief, the process for establishing a PT pursuant to the Company Law involves the following steps:

- reserve the name of the company;
- filing to the Indonesian Investment Coordinating Board (BKPM) if the PT is a foreign investment company;
- signing of the deed of establishment;
- filing for certificate of company domicile;
- filing for taxpayer registration number and taxable entrepreneur confirmation number;
- opening bank account and capital injection;
- filing for Ministry of Law and Human Rights (MOLHR) approval of the deed of establishment;
- registering the company office;
- announcement of the deed of establishment by MOLHR; and
- filing for a business licence (ie, BKPM business licence if the PT is a foreign investment company or a trade business licence if the PT is a local company).

It takes approximately two months for companies to obtain a legal entity and four months to be ready to commence commercial business activities.

It is free of charge to establish a new company, except for the costs involved in reserving the name of the PT and in notarising documents.

Note that if the PT is established with the status of foreign investment company because of foreign equity participation, any investment made by such PT will be considered as foreign investment and foreign ownership restrictions may be applicable for certain lines of business.

For non-conventional structures, a fund can also be established in the form of a limited participation collective investment contract (KIK-UPT). KIK-UPTs are regulated under the Financial Services Authority (OJK) Regulation No. 37/POJK.04/2014 on Mutual Fund in the Form of Limited Participation Collective Investment Contract (OJK Regulation 37). The formulation of a KIK-UPT is subject to OJK Regulation 37 and relevant regulations on the mutual fund and it must be registered with the OJK. The fund must be managed by a qualified investment manager, having net asset value of at least 1,000 rupiah as a start and based on a collective investment contract that meets requirements stipulated under OJK Regulation 37. Distinguished features of a KIK-UPT compared with a conventional mutual fund are that this fund can only invest in debt securities not offered by an IPO and equity securities that are not issued by a publicly held company.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Generally a private equity fund vehicle does not need a custodian, administrator or a corporate secretary unless the form of it is KIK-UPT or a mutual fund, in which case it must have a bank custodian and fund manager who are licensed under the OJK. It should also maintain books and records and have a registered office.

If the private equity fund vehicle is in the form of a PT, it must have a registered office and its board of directors must maintain the shareholders register, books and records under the Company Law. The failure to maintain and keep those records could constitute negligence on the part of the board of directors for which they are personally and jointly liable for any losses that may be suffered.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The MOLHR provides a database consisting of general information of companies, which can be requested by the public. This database is

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automatically updated every time the PT deals with the MOLHR for any corporate actions (eg, transfer of shares, change of capitalisation) involving the notary that has access to the database.

The information provided by the MOLHR is limited to general information related to the company such as the shareholders, amount of shares and line of business of the company. The information may not include the portfolios of the private equity. It should also be noted that the quality or reliability of the information contained in the MOLHR database is not yet conclusive, and there is always a risk that the registry has not been updated with the most recent information. Furthermore, there is a risk that the company profile may not reflect any legal issues or non-compliance of past corporate actions. To access the information, an online request to the MOLHR and payment of a fee are required.

As for mutual fund KIK-UPTs, the investment manager must comply with mandatory disclosures stipulated under capital market regulations including disclosure of information on the product structure and risk assessment to its potential investor.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Any investors, including third-party investors, shall be respected as a matter of Indonesian laws as long as they have invested and have interest in Indonesian companies. However, under the Company Law, the investor or shareholder shall not be liable for the company's losses extending beyond the value of shares he or she owns.

The Company Law recognises the concept of piercing of the corporate veil. Under this concept a shareholder of a PT shall not be personally liable for the consequences of binding agreements entered into in the name of the PT and shall not be personally liable for the PT's losses extending beyond the value of shares he or she owns. However, there are some exceptions to this general rule in the following cases (the piercing of the corporate veil concept):

(i) the PT does not have the status of a PT as a legal entity;
(ii) the relevant shareholder, either directly or indirectly, appropriates the PT in bad faith for his or her personal benefit;
(iii) the relevant shareholder is complicit in an unlawful act committed by the PT; or
(iv) the relevant shareholder, either directly or indirectly, unlawfully utilises the PT's assets, causing such assets to be rendered insufficient to pay off the debts of the PT.

In the case of (ii), (iii) and (iv), the Company Law provides that the burden of proof is with the third party intending to raise a claim against the shareholders of the company concerned. Nevertheless, as court decisions are not a matter of public record in Indonesia it is not clear how frequently the corporate veil has been pierced in the courts.

A shareholder's liability may exceed the capital paid on all of the shares he or she owns if it is substantiated that, inter alia, the shareholder's personal assets are commingled with the company's assets, or the company is established solely as a vehicle for manipulation by the shareholder in pursuit of his or her own benefit, as intended by (ii) and (iv).

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

In the case of mutual funds and KIK-UPTs, pursuant to OJK Regulation No. 43/POJK.04/2015 regarding Code of Conduct of Fund Managers (POJK No. 43), fund managers shall carry out their work based on the following principles:

- integrity;
- professionalism;
- prioritising customers' interests;
- monitoring and supervising;
- ensuring sufficient resources;
- protecting customers' assets;
- disclosure;
- avoiding any conflict of interest; and
- compliance.

These are fundamental principles so they may not be waived or exempted by agreement entered by and between the fund manager and investor. On the other hand, for privately held companies, there is no strict principle relating to fiduciary duty. Fiduciary duty can be modified as long as it does not result in the piercing of the corporate veil as discussed in question 5.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Indonesian laws do not explicitly recognise gross negligence or ordinary negligence. However, it is adopted from relevant doctrine in the field of civil law and up to the sole discretion of the judges to determine certain circumstances in which the limitation of liability may be acceptable.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The restriction factors stated in the negative list of investment (which was last revised on 12 May 2016 pursuant to the Presidential Regulation No. 44 of 2016 Regarding Lists of Business Fields That Are Closed to Investment and Business Fields That are Conditionally Open for Investment) should be considered when doing business in Indonesia.

Conditionally open business fields are specified business fields that investors may engage in with specified conditions. The aforementioned conditionally open lines of business are as follows:

- those that are reserved for micro, small and medium-sized enterprises and cooperatives;
- those for which a partnership is required;
- those for which certain shareholding arrangements are required;
- those that may be conducted only in certain locations; and
- those for which a special licence is required.

The negative list restrictions feature prominently in the structuring of acquisitions, as well as considerations such as exit method, dividend repatriation and tax.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Pursuant to Indonesian bankruptcy law, from the point of a bankruptcy declaration, the debtors (in this case the institutional sponsors) are no longer entitled to all of their assets. Afterwards, the assets and the business of the institutional sponsors will be managed by receivers or curators.

In the event of change of control or restructuring, the company has to make sure there is no negative covenant regarding such transactions. After completing the transactions, the company must submit a report to the MOLHR regarding the change of control or the restructuring. Furthermore, the transaction that may result in the change of control is also subject to certain requirements (eg, newspaper announcement) under the Company Law.

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Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The OJK is an independent institution whose functions are to establish an integrated regulatory and supervisory system for all activities in the financial services sector, including banking, capital market, insurance, pension funds, financing institutions and other financial services institutions. Therefore, if a private equity fund conducts business activities in such sectors or has become a publicly held company and subject to capital market regulation, then it will also be supervised by the OJK.

With respect to inspection rights, the OJK as a regulatory body may conduct supervision, inspection, investigation, consumer protection and other actions towards financial services institutions, subjects, or supporting activities to a private equity fund.

For investors, in the forum of a general meeting of shareholders, shareholders are entitled to have access to any information relevant to the company from the board of directors or the board of commissioners to the extent relevant to the agenda of the meeting and not in contravention of the interest of the company.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Investment in certain sectors (including banking, insurance, mining and finance) requires advance approval from the competent government authority and if it involves foreign capital an approval from BKPM may be required. A foreign sponsor may also consider forming a venture capital company (VCC) if it wishes to have significant portfolios in micro, small or medium-sized businesses that are closed or conditionally open for foreign investment as any investments made by VCC will be considered as local investment.

A VCC is known as a business entity that conducts financing activities or capital participation in a micro, small or medium-sized business that needs financial support to grow. A VCC can be established in the form of a PT, a cooperative or a limited partnership company and it must secure a business licence from the OJK prior to engaging in venture capital business. A VCC in the form of a PT has a minimum paid-up capital requirement of 50 billion rupiah. In general a VCC may conduct the following business activities:

- a venture capital business, which refers to provisions regarding investment capital or financing facilities to individuals, cooperatives, micro, small or medium-sized business;
- venture fund management;
- fee-based services, including consultation services on the management, accounting, administration and marketing of financial products such as insurance or mutual funds; and
- other activities approved by the OJK.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Under Indonesian law, there is no requirement for a private equity fund's manager, or any of its officers, directors or control persons to register as an investment adviser.

Investment managers that manage securities in capital market or KIK-UPTs are subject to compliance with capital market regulation. Among other things, they must be registered with the OJK and be a member of the investment managers association. Furthermore, the investment manager representative or individual who is in charge of the investment management business must also hold certification recognised by the OJK and be experienced in the capital market industry.

For VCCs, at least one of the members of the board, director or party who manages the investment must have a minimum of two years' operational experience either in a VCC, bank or other financial institution.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

In terms of a publicly held company, the fund manager shall be a member of the investment managers association, which has a code of conduct and is recognised by the OJK under POJK No. 43. Furthermore, investment manager representatives must comply with OJK Regulation No. 25/POJK.04/2014 regarding Licensing of Investment Manager Representative (POJK No. 25). POJK No. 25 provides that investment manager representatives must meet integrity requirements, competency requirements, have experience of working in financial institutions in Indonesia for foreigners and must not hold a position in another financial services institution.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

Under the Law on Corruption Eradication, companies are not permitted to give or promise something to a civil servant or state apparatus with the aim of persuading them to carry out, or not carry out, an action because of their position. In such circumstances, the related parties will be punished with imprisonment or fine sanctions, or both.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Such activities have not yet been regulated.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Bank Indonesia has monetary policy to restrict certain transactions involving banks. These policies include the restriction on banks on owning productive assets in the form of shares and maintaining foreign exchange deposits at certain levels. Indonesian banks are also prohibited from extending credit for acquiring marketable securities (stocks, bonds and commercial paper). These policies are expected to mitigate the risk of spread of the global financial crisis in Indonesia .

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Yes, private equity fund vehicles, as well as the fund distributed to investors in the form of dividends, will generally be subject to taxation. If it is

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formed as mutual funds, the benefit distributed by the mutual funds to the unitholder may be exempt from income tax.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

An individual investor is regarded as tax-resident if he or she fulfils any of the following conditions:
- he or she resides in Indonesia;
- he or she is present in Indonesia for more than 183 days in any 12-month period; or
- he or she is present in Indonesia during a fiscal year and intends to reside in Indonesia.

Indonesia imposes withholding tax of 20 per cent on interest or dividends payable to non-residents, unless the non-resident has a permanent establishment in Indonesia (in which case, the tax rate for residents would apply). If the non-resident is a resident of a country with a double taxation treaty with Indonesia, the withholding tax could be lower (subject to completion of Form DGT-1). See question 21.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

There are no special tax rules for private equity in Indonesia. A private equity fund vehicle set up in Indonesia or with effective management in Indonesia must obtain a taxpayer identification number and will generally be subject to the normal 25 per cent income tax rate. As for resident taxpayer investors, they are subject to normal withholding tax of 15 per cent on interest or dividend.

If private equity funds are incorporated abroad, they would generally be subject to 20 per cent withholding tax for income in the form of dividends, interest or royalties but this rate can be reduced via an applicable tax treaty. With regard to the capital gain, there would be 5 per cent withholding tax upon the gross sale proceeds of shares unless a relevant and applicable tax treaty waives it.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

Organisational tax is not recognised in Indonesia.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

With respect to the private equity fund's sponsor, there is a tax issue to consider in the event of the transfer of shares. The transfer of shares may result in the payment of income tax as a result of capital gain, which shall be borne by the seller, under the following conditions:
- if the seller is an Indonesian tax subject, the obligation to pay tax on the capital gains is the seller's. The rate would generally be 25 per cent for corporate taxpayers and up to 30 per cent for individual taxpayers. There is no obligation on the part of the buyer to withhold any amount from the sale price; and
- if the seller is not an Indonesian tax subject, the resident buyer must withhold 20 per cent of the estimated net income (ie, the capital gain amounting to 25 per cent of the transaction value) to the seller from the sale of the shares, except where the taxation of capital gains is reserved for the treaty partner by an applicable tax treaty. To obtain the benefit of the applicable tax treaty, the seller must comply with the certification, eligibility, information and reporting requirements in force in Indonesia. Currently, the seller would need to provide to the purchaser and the company a certificate of tax domicile issued by a competent tax authority (the Internal Revenue Services).

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Currently Indonesia has approximately 60 tax treaties with other counties such as Australia, China, Germany, Hong Kong, Japan, Korea, the Netherlands, Singapore and the US. The purpose of these treaties is generally to avoid double taxation and to prevent fiscal evasion with respect to taxes on income and capital. Principally these treaties regulate which income or capital should be taxed by a country to avoid double taxation.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Tax consideration may shape the exit option. Typically, private equity exits are done via IPO. This exit route is attractive, tax-wise. The sale of shares listed in an Indonesian exchange is subject to a favourable tax rate of 0.1 per cent (with an additional 0.5 per cent founder tax). Another common exit strategy would be the sale of investment instruments (eg, shares, warrants, convertible bonds, etc) in the offshore holding company (which normally resides in a low tax jurisdiction).

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

The negative list restriction factors, as mentioned in question 8, should be considered in the offer and sale of interests. In addition, funds sold or transferred to any investors must be registered or notified to the MOLHR.

However, the restriction on the negative list may be anticipated by gaining capital from other sources such as venture capital whose business activities are to conduct financing activities and capital participation in other companies.

Alternatively, the company can also make an investment through a stock exchange (capital market) since the capital participation publicly held company is deemed as a national investment, which is not subject to the negative list. In the event the offer of investment is made to more than 100 parties or sold to more than 50 parties or via mass media, the public offering procedures must be observed and it would be subject to mandatory disclosure, which covers all information regarding the issuer itself and the securities to be offered. The issuer must also submit a registration statement in the Indonesian language to the OJK.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Pursuant to the Investment Law, domestic investors and foreign investors who make investments in the form of a PT are prohibited from entering into an agreement or making a statement asserting that share ownership in a PT is for and in the name of another person (nominee arrangement). If nominee arrangements must be made (normally if investors wish to circumvent the foreign ownership restriction), they should be very carefully structured to avoid possible arguments of violation of Indonesian laws and regulations on foreign investment.

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26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Every change in the ownership, board of directors or board of commissioners of a PT (including a PT that engages in private equity funds) must be reported or notified to the MOLHR. This is an administrative requirement that does not affect the validity of such changes.

As for mutual funds, there is no specific requirement to notify government agencies on the identity of investors. However any changes to composition portfolios and management control are subject to disclosure requirement and approval from the OJK.

Specifically for VCCs, changes regarding companies' organisational structure, business activities or address must be submitted to the OJK within the following period:

- 15 days after any changes to a company's organisational structure have been approved or administered by the MOLHR;
- 10 days after any changes made to a company's address (headquarters or branch offices); and
- each time a company intends to engage in a new type of business activity.

The company is also required to submit a self-assessment report that covers the implementation of good corporate governance principles and this report must be finished by the end of the fiscal year and submitted no later than 30 April of each year to the OJK.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Generally in direct investment, there is no need for the person offering interests in a private equity fund to have a licence or registration. However, when a transaction is conducted in the capital market area, the person must have a licence and be recognised by the OJK.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Pursuant to the Anti-Money Laundering Law, any entity (including a private equity fund) is obliged to report to the relevant authority (in this case the Centre for Financial Transaction Reporting and Analysis (PPATK)) if there are any suspicious or unusual transactions. The report may be in the form of records, disclosure of identities, etc. After reporting, the PPATK will take further action and may request additional information.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds in the form a PT or mutual funds may be listed on a stock exchange and become a publicly held company or exchange traded funds. The advantage of being a publicly held company is that the liquidity of capital can be increased as it attracts retails investment.

However, the disadvantage of being a publicly held company is the relative expense of maintaining it as it becomes subject to various capital market compliance requirements (eg, disclosure requirements) before entering into particular transactions.

The principal initial and ongoing requirement for listing is by submitting a registration statement to the OJK along with supporting documents. Afterwards, the company must conduct an IPO to sell its shares to the public in a stock exchange.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Generally, there is no prohibition on any party making certain restrictions; however, if the listed fund is an exchange traded fund, interest in such funds can be freely transferred to any investor.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Some of the regulatory restrictions are, among others, as follows:

- any agreement with an Indonesian party would need to be translated pursuant to article 31 of Law No. 24 of 2009 (the Law on Flag, Language, Emblem, and National Anthem);
- Law No. 13 of 2003 (the Labour Law) contains provisions that give the right of employees to terminate their employment and ask for severance payment in the case of change of control;
- article 28 of Law No. 5 of 1999 (the Anti-Monopoly Law) provides that some joint ventures may be subject to mandatory merger control requirements; and

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- Bank Indonesia Regulation No. 17/3/PBI/2015 provides that the rupiah must be used in certain cash and non-cash transactions occurring in the territory of Indonesia, apart from certain exempted transactions.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

If the private equity fund is set up in Indonesia, the sponsor's ability to take profit from the fund may be in the form of management or transaction fees or a bonus that may be subject to transfer pricing regulations and a debt-to-equity ratio. The interest payment to the sponsor having control over the fund may also be constructed as dividend payment. The dividend payment (annual or interim) from a PT should observe the 20 per cent mandatory reserve as required by the Company Law.

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Israel

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Private equity funds formed in Israel are generally limited partnerships under the Israeli Partnership Ordinance (New Version) 5735-1975. Israeli limited partnerships have a separate legal personality under Israeli law. The limited partners do not participate in management and enjoy limited liability, while the general partner manages the affairs of the partnership and bears unlimited liability for the liabilities of the partnership. The general partner is usually incorporated as a limited partnership or as a limited company, in order to limit the personal exposure of the principals.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The first step in the process of forming an Israeli limited partnership is to determine which entity (pre-existing or formed for such purpose) will serve as its general partner. To the extent it is not a pre-existing entity, it needs to be formed. If the general partner will be an Israeli company, one can be formed within a few days with relatively simple formation documentation. If the general partner will be an Israeli limited partnership, its general partner needs to be identified and, if it is determined not to use a pre-existing entity, formed. In the event that the general partner is an Israeli limited partnership, an application to form the general partner as an Israeli limited partnership has to be filed with the Israeli Companies and Partnerships Registrar. The registrar can take up to seven business days in responding to these applications. Once the general partner is formed, an application to form the fund as an Israeli limited partnership has to be filed with the registrar. Again, that process can take up to seven business days.

Fees

- Formation of Israeli company: 2,614 Israeli shekels;
- formation of Israeli limited partnership: 2,614 Israeli shekels;
- annual registration fee for Israeli company: 1,488 Israeli shekels, unless paid before 31 March of the applicable year, in which case the annual registration fee is 1,120 Israeli shekels; and
- annual registration fee for Israeli limited partnership: 1,484 Israeli shekels, unless paid before 31 March of the applicable year, in which case the annual registration fee is 1,120 Israeli shekels.

Annual registration fees for both partnerships and companies may be updated from time to time.

Israeli attorneys are engaged in the process of forming private equity funds and their respective general partners.

While registering an Israeli limited partnership there is a need to declare what amount each limited partner will invest in the partnership, but there are no minimum capital requirements.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A private equity fund formed in Israel is not required to maintain a local custodian or administrator. The partnership's books and records should be kept at the partnership's main place of business, and they should be available to each of the partners. While the Israeli Partnerships Ordinance does not include any special instructions as to a partnership's registered office, the Partnerships Registrar will not register a partnership whose registration application does not provide an Israeli address for the partnership.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The names and capital contributions of limited partners of an Israeli limited partnership are required to appear in the Partnerships Register (which is available to the public) in order to ensure that they benefit from limited liability. A failure to so appear could jeopardise the limited liability of the limited partners. The limited partnership agreement of the partnership, as well as any amendment thereto, should also be filed with the Partnerships Register.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

If the third-party investors are not properly registered in the Partnerships Register or they take part in the management of the partnership, they could be characterised as general partners with unlimited liability.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The general partner of an Israeli limited partnership does not have formal fiduciary duties towards its limited partners. However, the Partnerships Ordinance requires all partners to manage the business of the partnership to their mutual benefit, to be honest towards, and faithful to, each other, and to give each other true accounts and full information in connection with the partnership. Since in a limited partnership the only partner that manages the business of the partnership

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is the limited partner, this instruction is relevant only with respect to the general partner.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Israeli statutory law does not define the term 'gross negligence'. However, certain Israeli court decisions do use this term from time to time, and generally define it as a major deviation from the reasonable level of caution. The term gross negligence has been used in Israeli case law in connection with general partners of limited partnerships, but there has not been extensive discussion as to whether it is an acceptable standard of liability. Limited partnership agreements of Israeli private equity funds generally incorporate gross negligence as a standard of liability applicable to the general partners of those funds. However, owing to the limited nature of guidance on this point under Israeli law, certain of those agreements refer to the laws of the state of Delaware in the United States for interpretation of the term 'gross negligence'.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are no Israeli regulatory requirements as to transfer and withdrawals (other than the need to update the Partnership Register), restrictions on operations, modifications to ensure fiscal transparency, special investor governance rights on matters such as removal of the manager or early termination of the vehicle, or limitations on the number of investors that relate to private equity funds. However, it is customary to include certain restrictions and requirements in the limited partnership agreements of private equity funds, including, inter alia, restrictions on the ability of the limited partners and the general partner to withdraw from the partnership and to transfer their interests in the partnership, restrictions on ability of the general partner to cause the fund to enter into certain transactions, giving the limited partners the ability to replace the general partner upon the occurrence of certain conditions or terminate the fund early.

It is not possible to convert or redomicile entities in Israel.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

There are no legal or regulatory consequences in the event that a limited partner that is a private equity fund's sponsor enters bankruptcy or insolvency or undergoes a change of control or restructuring. The Partnerships Ordinance states that, contrary to general partnerships, limited partnerships are not required to be dissolved in the event that a limited partner (whether it is a sponsor or a regular limited partner) becomes bankrupt, and there are no instructions as to insolvency, change of control or restructuring of a limited partner.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Generally, private equity funds are not subject to governmental regulation, assuming that they do not engage in public offerings of their interests (which are subject to regulation by the Israeli Securities Authority). The Israeli law applicable to investment advisers does not apply with respect to privately held entities. However, funds that provide credit are subject to the Israeli Supervision of Financial Services (Regulated Financial Services) Law 2016, and to the Procedure for Licensing Service Providers in a Financial Asset or Granting of Credit, dated 15 November 2017. According to that law and procedure, no person shall practise in providing services with respect to a financial asset or provide credit, unless it was granted a licence for such practice. The Supervisor of Financial Service Providers is in charge of granting the required licences. The procedure lists numerous documents that should be attached to each licence request, and states that the supervisor may request to receive additional information that it believes to be necessary for the inspection of such licence request. If a licence was granted, and any of the information that was provided to the supervisor has changed, the licensee has to inform the supervisor within 10 days from the date upon which it has been informed of such change.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

See question 10.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

No. See question 10.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The only types of managers subject to such requirements are managers of funds providing credit, as specified in question 10.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The Israeli Parties Financing Law 1973 states that an Israeli political party shall not receive funding from entities, whether directly or indirectly and whether those are Israeli or non-Israeli entities. Accordingly, a manager or adviser cannot make political contributions. With respect to individuals, according to the Israeli Parties Financing Law 1973 a party shall generally not accept more than 1,000 Israeli shekels a year per individual and his or her family members who are financially dependent on him or her, or 2,300 Israeli shekels in an election year. Furthermore, according to the Israeli Parties Law 1992, an individual who participates in elections to the Knesset shall not accept more than 10,000 Israeli shekels a year per individual and his or her family members who are financially dependent on him or her. According to the same law a contribution must be reported within 14 days.

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15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

The Israeli Knesset Law 1994 states that lobbyists who act in the Knesset should be authorised by a special committee of the Knesset. There is no regulation that restricts private equity funds from approaching governmental entities. There are no special pension plans for public employees.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Under Israeli law, Israeli banks cannot hold more than 20 per cent of the interests in any entity. This means that in many instances Israeli banks will not serve as sponsors of private equity funds.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Since private equity funds are formed as partnerships, the funds themselves are not subject to entity-level Israeli taxation.

Israeli private equity funds are usually formed as Israeli or foreign partnerships. For Israeli tax purposes a partnership is a disregarded entity and the limited partners of the partnership are the ones who are subject to tax regarding the partnership's income, as if such income were realised directly by the investors, regardless of whether such income is actually distributed. Under applicable double tax treaties, the non-Israeli limited partners in an Israeli private equity fund may be exempt from tax in Israel with respect to certain types of income. Usually an Israeli private equity fund applies to the Israeli tax authorities for a tax ruling, as described below.

Also, under the Israeli tax ordinance, a distribution from a partnership is not subject to tax, therefore a fund should not be required to withhold tax with respect to distributions to its limited partners. With respect to distributions of carried interest to the general partner of the fund, see question 21.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Usually, a non-Israeli tax resident is exempt from capital gains tax from the sale of the shares of an Israeli company, under certain conditions. However, a non-Israeli tax resident is subject to tax on Israeli source dividends (at a tax rate of 25 per cent, or 30 per cent in the case of a shareholder holding directly, indirectly or constructively, 10 per cent or more of certain interests in the distributing company (a 'substantial shareholder')) and interest income (at a tax rate of 15 per cent (with respect to certain financial instruments not linked to the CPI) and 25 per cent (which is also the general rate applicable to interest received by foreign persons) or marginal rates if the interest is derived by a substantial shareholder), all subject to certain tax reliefs and double tax treaties. In addition, foreign residents are generally exempt from Israeli capital gains tax on gains from the sale of securities of Israeli-resident companies, unless the gain is attributable to a permanent establishment of the seller in Israel (including a permanent establishment by virtue of investment in a vehicle with such a permanent establishment in Israel).

A non-Israeli tax resident who derived taxable Israeli source income in the taxable year is required to file an Israeli income tax return. However, a non-Israeli tax resident shall not be subject to return filing obligations in Israel, if the required tax was withheld from his or her income and his or her income is from one of the following:

- a business or profession conducted in Israel for no more than 180 days in the year;
- passive income (such as dividend, interest, royalties, etc); or
- salary income and pension.

Israeli banks are required to withhold tax from most payments to a non-Israeli tax resident, usually at a 25 per cent tax rate. It is necessary to apply upfront to the Israeli tax authorities for a tax withholding exemption in accordance with the provisions of the relevant double tax treaty or Israeli tax laws.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is recommended to apply for a tax ruling from the Israeli tax authorities with respect to the tax treatment of a private equity fund. Said tax ruling provides assurance regarding the tax consequences applicable to the foreign investors in the fund. It provides, subject to its terms, that non-Israeli investors in the fund shall not be regarded as Israeli tax residents and shall not be subject to return-filing obligations in Israel solely as a result of their investment in the fund. It also provides the tax rates and exemptions to apply on a non-Israeli tax resident. Please note that the Israeli government is currently reconsidering its tax ruling policy.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

The organisational fees are as stated in question 2.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Management fees are subject to Israeli income tax at ordinary rates (which depend upon the identity of the payee). An individual is subject to marginal tax rates of up to 47 per cent for 2017 (exclusive of national insurance and health taxes, which may also apply) and to a 3 per cent surtax if the individual's taxable income exceeded 640,000 Israeli shekels (for 2017). Hence, the individual marginal tax rate can be 50 per cent plus national insurance and health taxes. Companies are subject to tax on their income and gains at a flat tax rate of 24 per cent as of 1 January, 2017, which is expected to be reduced to 23 per cent in 2018.

Usually, following the issuance of a tax ruling, a private equity fund will also apply for favourable tax rates for income derived from carried interest by the general partner of the fund. The Israeli tax authority holds the position that carried interest income is business income. Under such tax arrangement the applicable tax rate on carried interest shall be determined based upon the composition of the fund's investors.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Israel is a party to many double tax treaties, for example, with Germany, India, the United Kingdom and the United States.

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23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Value added tax (VAT) will also apply to management fees; however, a VAT ruling can be provided by the Israeli VAT authorities under which VAT at zero rate of applies to management fees with respect to the proportional share attributable to foreign investors in the fund. Currently, the applicability of VAT to carried interest is not clear; however, to our best knowledge the Israeli VAT authorities have not issued a tax assessment regarding such matter.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

An Israeli limited partnership should register with the Partnership Registrar the identifying details (full legal name, registration number and address) of its limited partners, as well as the sum that was invested by each limited partner. In addition, the Israeli Securities Law 1968 determines that an entity that offers securities to more than 35 prospective investors in any 12-month period must first publish a prospectus. However, some investors are not counted for the purpose of the 35-investor limitation (including, inter alia, pension and provident funds, financial institutions, insurance companies and high-net-worth investors meeting Israeli accreditation standards).

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are no restrictions as to the types of investors who may participate in private equity funds formed in Israel.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Yes, as stated in question 24, Israeli limited partnerships should register with the Partnership Registrar the identifying details (full legal name, registration number and address) of their limited partners, as well as the sum that was invested by each limited partner. In addition, Israeli limited partnerships should report each transfer of limited partnership interests between existing limited partners or from an existing limited partner to a new one.

If the general partner has been replaced, the Partnership Registrar should be informed as well. If the general partner remains the same entity, but there were changes in its ownership or in its directors (if applicable), then the entity that acts as general partner should inform the relevant registrar (the Companies Registrar if the general partner is a limited company and the Partnerships Registrar if the general partner is a limited partnership), as should any entity if it undergoes such changes.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

No.

Update and trends

Following a recent report issued by the Israeli state comptroller, the Israeli Tax Authority announced that it is currently reconsidering its tax ruling policy regarding investment funds, and is not currently issuing such rulings. It is expected that the government will formalise a plan to enable foreign investors in venture capital funds, and probably in certain private equity funds, to be entitled to tax holidays in respect of gains from such funds.

On 31 December 2017 the regulations that enabled institutional investors to pay certain third parties any fees incurred in connection with their investments in mutual funds and certain private funds expired. The Israeli Ministry of Finance is currently discussing the possibility of extending the said regulations, with retroactive effect. The finance committee of the Israeli parliament is expected to discuss new proposed rules during the first quarter of 2018.

There have been legislative proposals to replace the Israeli Partnerships Ordinance in its entirety, in order to modernise the formation and operation of partnerships in Israel and to bring the field into line with the law in other industrialised countries. Obviously, the adoption of new legislation could have a material impact on the formation of Israeli private equity funds.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Israeli Prohibition of Money Laundering Law 2000 does not refer specifically to private equity funds, but most private equity funds do perform certain know-your-client and anti-money laundering procedures with regard to their investors, asking them to complete questionnaires, to provide identifying documents and to provide information as to their directors and beneficial owners. In addition, Israeli banks that provide services to private equity funds are required to receive certain information regarding the investors, as well as IRS forms (W-9 or W-8, as applicable).

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

According to the Partnerships Ordinance, Israeli limited partnerships (whether or not they are serving as private equity funds) can be listed on the Israeli stock exchange. However, according to the Tel Aviv Stock Exchange, it is possible to list only limited partnerships whose sole business is either locating oil or gas or producing movies.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

There are no legal restrictions on transfers of interests in a listed fund. However, the fund can impose such restrictions in its limited partnership agreement.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

No.

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32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

The ability of a sponsor to take part of the income of the general partner depends on the regulation applicable to the sponsor. For example, sponsors that are institutional investors or banks are subject to certain regulations that prevent them from taking more than a certain portion of the carried interest to which the general partner of a fund is entitled.

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Italy

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The main vehicles used for private equity funds in Italy are investment funds organised as a collective investment scheme structured as a separate pool of assets (FCIs) or funds structured as corporations, namely variable capital investment companies (SICAVs) or fixed capital investment companies (SICAFs).

An FCI is a collective investment scheme, typically managed by an external Italian asset management company (SGR). Assets in FCIs are separate for all purposes from the assets of their investors, the SGR and any other assets managed by the same SGR.

A SICAV is an open-ended investment fund in the form of an Italian joint-stock company with variable capital, whereas a SICAF is a closed-ended investment fund in the form of an Italian joint-stock company with fixed capital. Both these corporations are formed for the exclusive purpose of collective investment of assets and they could be managed internally by their internal governing body or externally by an SGR.

Each of the above-mentioned legal vehicles also typically qualifies as an Alternative Investment Fund (AIF) pursuant to European Directive No. 2011/61/EC on Alternative Investment Fund Managers (the AIFMD), as reflected in the Italian legal framework.

Until very recently, it was unclear whether private equity funds structured as FCIs could be deemed to have legal personality. Often, FCIs' assets and legal relationships were considered separate from those of the investors and of the managing entity but not directly owned by the investment fund itself. A very recent decision by the Milan tribunal (No. 7232/2016) instead established that private equity funds should be considered as entities with their own legal personality, thus entitled to own in their name all the assets of the investment funds.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of a private equity fund generally requires the adoption of the fund rules or the articles of associations or by-laws of the relevant entity, the appointment of the management entity and, in certain situations, the approval by the Bank of Italy of the fund governing documents.

FCIs that are reserved for investment by professional investors may be formed relatively expeditiously by authorised SGRs, subject only to the adoption of appropriate fund rules and a notification to the Bank of Italy.

SICAVs and SICAFs are additionally subject to compliance with certain corporate requirements including, but not limited to the following:

- the adoption of the legal form of Italian joint-stock companies;
- the establishment of the registered office and head office in Italy;
- the adoption of the minimum fully paid-up capital (see question 12);
- experience, independence and integrity requirements for persons performing administrative, management and supervisory functions; and
- specific integrity requirements for persons holding a controlling interest in the investment funds.

As regards FCIs, corporate requirements similar to those listed above apply to their SGRs, as mentioned in question 12.

In addition to corporate law requirements, the formation of an AIF also requires a prior authorisation by the Bank of Italy of the Italian AIF manager. It should be noted that, pursuant to the AIFMD passport, European authorised managers may also carry out management activities in respect of Italian private equity funds, based on their home European State authorisation and subject to a prior notification to the Italian competent authorities (see question 12).

As a general rule, the involvement of a public notary is not required in the formation process of a private equity fund; however, as the SICAVs, the SICAFs and the asset management companies for FCIs are joint-stock companies, the formation of these entities requires a notarisation of their formation deed and the relevant publication in the Italian commercial register.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

The assets of Italian private equity funds (retail or non-retail) must be held through a separate local custodian authorised by the Bank of Italy to provide depositary services to investment funds. Italian law expressly requires that fund managers appoint a depositary for each investment fund they manage. The depositary is liable in accordance with Italian law towards the fund manager and to fund investors for any loss suffered by them as a result of the depositary's wrongful failure to perform its obligations.

Italian private equity fund managers are registered in the official list of regulated investment vehicles maintained by the Bank of Italy and must maintain a registered office in Italy. They are required to maintain books and records of each fund they manage in accordance with the provisions of the applicable law.

In general, fund administration is not a regulated activity in Italy. However, investment fund managers may outsource essential or important operations, services or activities, to fund administrators only to the extent that the administrators are qualified to manage the delegated functions with the diligence required by the nature of the assignment and as long as such fund managers remain responsible towards the investors for the actions of the delegated subjects. Fund managers must retain the ability to supervise the delegated third parties at all times, so as to be able to give further instructions with regard to the delegated functions at any time, and revoke such mandate with immediate effect, if and when appropriate to protect the interests of investors.

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Fund managers wishing to delegate to third parties specific duties related to the performance of their services are generally required to inform the Bank of Italy and the Italian Stock Market Regulatory Authority (Consob) of such intention.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

As private equity fund managers are typically registered with the Italian commercial register, certain information about the managing entities is a matter of public record.

However, as regards AIFs, no information on the identity of the investors or their commitments is disclosed or accessible by third parties.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Notwithstanding the interpretation of Italian courts on the principle of the legal personality of investment funds (see question 1), the limited liability of the investors has always been an undeniable milestone of the Italian legal framework, irrespective of the legal form of the private equity fund and of its regulated or non-regulated structure as well as any specific rule applicable to any investor pursuant to its respective country of incorporation. In fact, the liability of non-managing investors is limited to the amount of their commitment to the investment fund and in no event may investors be requested to contribute to the investment fund or to any third party any excess amount. The decision by the Court of Milan (No. 7232/2016) described in question 1 confirmed the principle of the limited liability of the investors.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

As a general rule, Italian fund managers are liable toward both private equity funds and their investors pursuant to Italian general civil law principles, for the execution of the mandate entrusted to them and for any misconduct in the management of the corporate affairs of the managed investment fund (misconduct does not necessarily imply a fault on the part of the fund managers, who may incur liability for their passive attitude, their negligence or their carelessness). The fund managers' fiduciary duties are governed by the same duty-of-care standard to act as a 'bonus pater familias' in similar circumstances for the execution of a similar mandate, as set forth in the Italian Civil Code: in particular, fund managers must act in a professional manner, with the diligence that can be expected from a prudent and diligent person with expertise in the management of private equity funds, and must comply with the relevant investment policies and constitutive documents.

Generally, such ordinary level of fiduciary duties may not be modified by an agreement among the parties nor treated differently in the constitutive documents of the private equity funds. Nevertheless, the governing documents of a private equity fund may provide for higher standards of fiduciary duties. It is also possible to limit the liability of the fund managers towards the investors or the investment fund by contractual provisions or in the formation documents of the private equity funds, excluding the fund managers' liability for 'ordinary negligence'.

As most Italian private equity funds qualify as AIFs, the fiduciary duties set forth in the AIFMD also apply to Italian AIF managers, and they may not be opted out of, or minimised by, contractual provisions among the parties. Such fiduciary duties require the Italian fund managers, inter alia, to act honestly, with due skill, care and diligence and fairly in conducting their activities, and in the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market; to have and employ effectively the resources and procedures that are necessary for the proper performance of their business activities; to take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, where applicable, disclose, those conflicts of interest; to comply with all regulatory requirements applicable to the conduct of their business activities; and to treat fairly the investors in an AIF.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Yes, as mentioned, Italian law distinguishes between 'gross negligence' and 'ordinary negligence', as described in question 6.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are several restrictions or requirements to private equity fund vehicles depending on the legal form of the vehicle and on whether they qualify as AIFs or not. For example, according to Italian law, certain restrictions apply to transfers of interests in Italian managers of private equity funds, as mentioned in question 26. Also, Italian private equity funds are subject to certain diversification and borrowing limits.

In general, Italian regulations do not allow limited partnerships formed in other non-European jurisdictions to redomicile in Italy. However, specific rules are provided with respect to cross-border mergers. European private equity funds do not need to redomicile as long as a European passport is in place (see questions 12 and 27).

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

As discussed in question 5, investment funds' assets are separate from the assets and liabilities of its managing entity and, as a result, the bankruptcy, insolvency or similar events at the level of the manager do not affect investment funds' assets and the interests of the investors.

However, the governing documents of the investment fund generally set forth the consequences of any such event of default at the level of the manager, which may include the right of the investors to terminate the investment period of the investment fund, to replace the manager or to liquidate the investment fund.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Consob and the Bank of Italy are the principal regulatory bodies that have authority over private equity funds and their managers. They both have very wide-ranging inspection rights on SGRs.

Specifically, the Bank of Italy is mostly responsible for the risk containment, asset stability and sound and prudent management of private equity funds and fund managers, whereas Consob is responsible for the transparency and correctness of their conduct. These

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authorities operate in a coordinated manner and notify each other of the measures adopted and the irregularities discovered in carrying out their supervisory activities.

Both the Bank of Italy and Consob have the ability to fine private equity funds and managers in the event of compliance, administrative and reporting irregularities, by taking the relevant and appropriate measures. In addition, in the event that the tenure of the corporate representatives of asset management companies, SICAVs and SICAFs is detrimental to the sound and prudent management of these qualified subjects, the Bank of Italy may order their removal.

AIF managers are required to provide Consob with yearly, half-yearly or quarterly information regarding the following:

- the main instruments in which they are trading;
- the principal exposures and the most important concentrations of the AIFs that they manage;
- the relevant markets where they actively trade;
- the overall level of leverage employed by each AIF;
- the illiquid assets and the relative arrangements for managing them;
- the current risk profile of the AIFs and the relevant risk management systems; and
- the main categories of assets in which the AIFs have invested.

Fund managers are required to disclose to investors on a yearly, half-yearly or quarterly basis, the following:

- the percentage of the AIF's assets that is subject to special arrangements arising from their illiquid nature;
- any new arrangements for managing the liquidity of the AIF;
- the current risk profile of the AIF and the risk management systems employed by the AIF manager in order to manage those risks;
- any changes to the maximum level of leverage that the AIF managers may employ on behalf of the AIF as well as any right of use of the collateral or any guarantee granted under the leveraging arrangement; and
- the total amount of leverage employed by the AIF.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Both the organisation of private equity funds and the activity of fund managers are subject to licensing processes and to compliance with specific requirements pursuant to Italian and European laws and regulations. These processes and requirements differ based on the features of the manager, the type of the investment fund and the prospective investors.

In general, with respect to private equity funds, the Bank of Italy must approve the fund rules of the investment funds (other than for AIFs reserved for investment by professional investors), as well as the relevant amendments. Private equity funds managers must be authorised by the Bank of Italy, as described in question 12. Special simplified authorisation requirements apply to managers of European Venture Capital Funds and European Social Entrepreneurship Funds.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

The activity of fund managers is subject to licensing and compliance processes pursuant to Italian and European laws and regulations. These processes and requirements differ based on the features of the manager, the type of the private equity fund and the prospective investors.

In order to obtain the authorisation to provide asset management services, irrespective of the nature of the managed investment fund, Italian fund managers must comply with a number of detailed requirements, including the following:

- the adoption by the fund manager of the legal form of an Italian joint-stock company;
- generally, a minimum fully paid-up capital of €1 million, subject to certain exceptions for managers of AIFs reserved to professional investors (for which the minimum capital is set at €500,000) and managers falling below certain thresholds in respect of assets under management pursuant to the AIFMD (for which the minimum capital is set at €50,000);
- experience, independence and integrity requirements for persons performing administrative, management and supervisory functions;
- specific integrity requirements for persons holding a controlling interest in the fund manager; and
- appropriate organisational and functional structures, as indicated in a specific report to be prepared for the benefit of the Bank of Italy.

After formation of the fund management entity and once these requirements are complied with, an authorisation request is submitted to the Bank of Italy. If all requirements and conditions are fulfilled, after a 90-day period from the submission of the request, the manager is expressly authorised by the Bank of Italy and listed in a special register held by the Bank.

The requirements described above apply to fund managers established in Italy. As a general rule, a foreign manager is not entitled to perform management activities or provide asset management services to Italian investors without complying with certain specific requirements pursuant to applicable Italian and European regulations. Such requirements differ depending on whether the overseas manager is a European or a non-European entity, and whether such manager is already authorised in its own country (the home country) as an AIF manager under the AIFMD.

A non-European fund manager must be authorised by the Bank of Italy or another competent European authority to perform management activities in Italy, while the performance of asset management activity in Italy by an authorised European fund manager requires a notification to the Bank of Italy by the competent authority of the home country of such fund manager.

Upon enactment of the Italian regulations on cross-border operations for authorised non-European investment fund managers, the Bank of Italy will list non-European fund managers authorised to perform services in Italy in a special section of the register held by such authority.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Managers of retail as well as non-retail private equity funds are subject to specific organisational and governance requirements that are intended to ensure sound and prudent management, risk mitigation, proper accounting reporting obligations and the resolution of conflicts of interest.

Among other things, in line with the European legal framework, Italian regulations expressly require that fund managers establish the following:

- a permanent internal corporate body with supervisory functions that oversees the investment strategies and remuneration policy of the managed investment funds (with respect to non-retail private equity funds, this requirement does not apply to managers falling within the AIFMD's definition of below-the-threshold fund managers);
- a remuneration committee responsible for the structuring of the remuneration policy of the fund manager (with respect to non-retail investment funds, this requirement does not apply to managers falling within the AIFMD's definition of below-the-threshold fund managers);
- a permanent internal corporate body with risk management and compliance functions, which operates independently and is not involved in the performance of services or activities it monitors; and
- a permanent internal corporate body with internal audit functions that maintains and evaluates the adequacy and the effectiveness of the internal control mechanisms and arrangements (with respect to non-retail investment funds, this requirement does not apply

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to managers falling within the AIFMD's definition of below-the-threshold fund managers).

Each of these functions (which, based on the size of the investment fund managed by the fund manager, either may or may not have to be entrusted to separate internal bodies) and related internal policies are also subject to periodic update and review.

In addition, fund managers are subject to several organisational and capital adequacy requirements such as the fulfilment of sound administrative accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms including, without limitations, rules for personal transactions by their employees or for the holding or management of investments in order to invest on their own account.

With respect to the periodic reporting requirements imposed on the fund managers, see question 10.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The Italian rules applicable to public and private political contributions have been recently amended. The applicable legal framework set forth specific limits and disclosure covenants with respect to political contributions, however there are no rules specifically applicable to managers or advisers of private equity funds.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no specific rules in Italy governing the marketing of regulated or non-regulated private equity investment vehicles to public pension plans and other governmental entities.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

The Italian legal and regulatory framework provides for some specific limits that affect banks with respect to investing in or sponsoring private equity funds. In particular, following the recent global financial crisis, the Bank of Italy has adopted a stricter approach, aiming to limit the risk of an excessive immobilisation of assets deriving from financial or non-financial equity investments and to promote sound and prudent management. Further to that, and to such an extent, the investment by banks in equity or immovable properties made through a third institution (ie, a private equity fund) has certain limitations, as follows:

- it is generally limited to the amount of own funds at a consolidated level;
- it may require authorisation by the Bank of Italy; and
- it is also subject to concentration limits and other organisation requirements, depending on the type of the investment.

Banks can also be affected by internationally driven changes to European legislation and the legislation of foreign jurisdictions, such as the Basel III regulations providing for stricter capital requirements for banks and classifying private equity as a high-risk operation.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Pursuant to the provisions of article 73 of the Italian Tax Code (Presidential Decree No. 917 of 22 December 1986, as amended from time to time), Italian private equity funds are treated as tax-neutral for Italian corporate income tax purposes provided that they, or their management companies, are subject to any form of supervision. Thus proceeds (dividends or capital gains) realised by them are exempt from Italian income taxes and could be received gross of any Italian withholding or substitute tax. In line with the interpretation of the Italian Tax Authority, investment funds resident in Italy are entitled to the application of double tax treaties (DTT), as mentioned in question 22.

The tax regime for investors depends on both the type of proceeds and investors as well as on the tax residence of the investors.

Italian-resident investors

Italian-resident investors are generally subject to a 26 per cent withholding tax on the distribution of proceeds by Italian private equity funds. As a general rule, corporate taxpayers who are resident in Italy according to Italian tax law are liable to corporate income tax (at a rate of 27.5 per cent, reduced to 24 per cent from 1 January 2017).

Foreign investors

Foreign investors, resident in countries that allow an adequate information exchange with Italy (the 'white listed countries' (WLC)) may obtain exemptions from taxes on some capital income and different income of a financial nature, as discussed in question 18.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Both in the case of capital income and capital gains realised through the sale of units, no taxation occurs if the recipient does not have any permanent establishment in Italy in addition to any of the following:

- for tax purposes, the recipient is resident in a WLC (and is the beneficial owner of the income);
- is an international entity or body set up under international agreements in force in Italy; or
- is a central bank or organisation managing official state reserves.

In the event of other foreign investors, a 26 per cent final withholding tax is levied by the private equity funds or the relevant management company on capital income, potentially reduced under any DTT, if existent and applicable as described in question 22.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

On 21 March 2016, the Italian Tax Authority updated its administrative provisions for the implementation of new rules on advance tax agreements for enterprises with international activities. According to these provisions, all enterprises with international activities may enter an advanced tax agreement with the Italian Tax Authority on specific subject matters, regarding, among others, transfer pricing and permanent establishment issues, application of company migration rules, taxation of inbound and outbound dividends, interest, royalties, etc, according to domestic legislation and DTT provisions.

After reaching an agreement with the taxpayer, the Italian Tax Authority issues a tax ruling, which is binding and remains in place

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for five fiscal years (potentially renewable) upon the condition that the juridical or factual circumstances of the agreement do not change and the taxpayer fully abides by its provisions.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant taxes associated with the organisation of a private equity fund in Italy, other than Bank of Italy filing and registration fees.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

As a general rule, corporate taxpayers who are considered resident in Italy pursuant to the Italian Tax Code, are liable to corporate income tax on their overall income, regardless of its sources (worldwide taxation principle). Management fees are exempt from VAT and subject to Italian corporate income tax in the hands of the SGR. Taxation of carried interest is still a controversial matter in Italy, but, in the event that it is received by the management company, it would be subject to standard Italian corporate income tax.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

As of April 2017, Italy had entered into approximately 94 DTTs with many foreign countries, both inside and outside the European Union, to avoid double taxation on income and property. These agreements provide for some specific rules governing the tax process of each category of income and, depending on the categories involved, they provide that both countries could tax the same income (concurrent taxation) or the exclusive taxation by one country only. Only foreign investors that are not resident in a WLC may rely on the DTT directly, submitting a request for refund.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

There are no other significant tax issues specifically related to private equity funds. However, Italian tax rules are very complex and constantly subject to significant changes, so that appropriate tax advice is highly recommended in most cases.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

The marketing of private equity funds is defined as the direct or indirect offer of interests, on the initiative or on behalf of a fund manager, addressed to resident or non-resident investors. Irrespective of whether such investment fund is an Italian or a European-regulated investment fund, such activity requires the prior filing by the fund manager of a notification with Consob, setting forth the business programme of the investment fund, its regulations or articles of association and, for investment funds not reserved for professional investors, the prospectus – and, in certain situations – an express marketing authorisation from Consob and the Bank of Italy. In general, no private placement is allowed for private equity funds, other than a mechanism of reverse solicitation. Notwithstanding the fact that there is no specific reference to the legality of reverse enquiry in the Italian laws, it has long been accepted by Italian scholars and regulators as exempt from public offer rules.

An exception to the general principles described above is expressly provided for Italian-authorised fund managers that fall within the AIFMD's definition of below-the-threshold fund managers and that market units or shares of Italian or European-regulated investment funds reserved for professional investors in Italy: these managers are not required to make any prior notification of their intention to market their private equity funds in Italy. Non-authorised, non-Italian or European fund managers intending to market units or shares of a foreign private equity fund in Italy have to comply with national rules on placement to local investors. Owing to the complexity of Italian placement rules, it is advisable, for the time being, to contract with an Italian-authorised fund manager that would carry out the authorisation procedure required periodically.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

In line with the applicable European legal framework, interests in non-retail AIFs may only be held by professional investors, defined as private or public investors that possess the experience, knowledge and expertise to make their own investment decisions and properly assess the risks that they incur, such as the following:

- entities that are required to be authorised or regulated to operate in the financial markets, in particular the following:
  - credit institutions;
  - investment firms;
  - other authorised or regulated financial institutions;
  - insurance companies;
  - collective investment schemes and management companies of such schemes;
  - pension funds and management companies of such funds;
  - commodity and commodity derivatives dealers;
  - members of a stock exchange market engaging in proprietary trading;
  - stockbrokers; and
  - other institutional investors;
- large undertakings meeting certain size requirements;
- other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions;
- the government and the Bank of Italy; and
- other national and regional governments, public bodies that manage public debt, central banks and international and supranational institutions such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other similar international organisations.

Investors other than those mentioned above, including public sector bodies and private individual investors, may also qualify as professional investors upon request. In such event, the Italian manager should perform an adequate assessment of the expertise, experience and knowledge of the client, based on certain standard tests and criteria. Interests in private equity funds in the retail sector may also be held by retail investors, which are defined by Italian regulations as those investors that do not have the specific professional experience, knowledge and expertise to make their personal investment decisions consciously and to properly assess the risks involved in this kind of investment.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Investors in private equity funds are not subject to any specific notification or approval from the Italian supervisory authorities. However, the Bank of Italy may request the management company to provide certain

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Update and trends

As described in questions 12 and 24, the forthcoming enactment of the European rules on the management and marketing in Italy of non-European AIFs, as well as the management and marketing in Italy of investment funds by non-European fund managers, is certainly the most significant likely future development in this sector.

information about the investors in connection with its inspections and verifications of the compliance with applicable rules.

Any physical or legal person that, for any reason, intends to acquire, directly or indirectly, an interest such as that person could have a significant influence on an Italian fund manager, or an interest that assigns a share of voting rights or capital of at least 10 per cent (by taking into account the shares or units already owned by the acquiring person) is required to notify the Bank of Italy before such acquisition. Advance notice shall be given for any changes in the shareholding of a fund manager when the share of voting rights or capital held directly or indirectly by a person is increased or reduced above or beyond 20, 30 or 50 per cent, and in any event when changes result in the acquisition or loss of control of the Italian fund manager. The Bank of Italy has 60 business days to deny the acquisition (or disposition) of the controlling interest if it considers that the sound and prudent management and financial soundness of the acquisition or disposition target are not fully guaranteed.

Voting and other rights related to the person that has control over a private equity fund manager exceeding the thresholds mentioned may not be exercised in the following circumstances:

- the prior notices have not been given;
- the Bank of Italy has denied the acquisition on the basis that the acquisition could be prejudicial for the private equity's sound and prudent management; or
- the time limit has expired.

In addition, the Bank of Italy and Consob, specifying the deadline for the response, may require Italian investment companies, asset management companies, SICAVs and SICAFs, to provide the names of the investors on the basis of the investors' register and other information available to them.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

As a general rule, regardless of whether the person marketing private equity fund interests is the fund manager, the offering of interests in investment funds in Italy is a regulated activity, so that any person marketing such interests is required to hold appropriate regulatory permissions or authorisations.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Italian private equity funds and their managers are subject to Directive No. 2015/849/EU of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, implemented in Italy by Decree No. 90 of 25 May 2017, which imposes extensive identification and reporting duties on Italian banks and financial institutions.

Due diligence measures for know your customer purposes include, without limitation, the following:

- identifying each investor on the basis of documents, data or information obtained from a reliable and independent source;
- identifying the beneficial owner, whose information are held in a national central register;
- taking 'reasonable measures' to understand the ownership and control structure of the investor;
- obtaining information on the purpose and intended nature of the business relationship; and
- conducting ongoing monitoring of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the professional's knowledge of the investor, the business and risk profile, including, where necessary, the source of funds and ensuring that the documents, data and information held are kept up to date.

The financial institutions must report any suspicious transactions and ascertain if the customer is or was politically exposed.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Since December 2014, it has been possible to list interests of FCIs, SICAVs and SICAFs qualifying as 'open-ended' investment funds on the Italian stock exchange, provided that the relevant fund complies with European Union Directive No. 2009/65/CE on Undertaking for Collective Investment in Transferable Securities (UCITS IV Directive) and that the fund's documents expressly allow the listing of the fund's interests on a regulated market. The minimum free float in connection with the initial public offering must be no less than €25 million. Specific requirements and placement conditions may be imposed by the Italian Stock Exchange Authority, which is the authority responsible for management and supervision of the Italian stock market.

The main advantages for the investors of the listing of investment funds' interests are the broadening of the accessibility to such financial instruments, the (expected) reduction of placement fees and 'entry fees' owing to the lack of placement agents and intermediaries and the increase of transparency. The main disadvantage for funds' sponsors and management entities is the increase of information to be provided to the investors and regulatory authorities.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

No specific limits to the transfer of interests apply to listed private equity funds.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

The rules applicable to Italian private equity funds set forth specific limits and restrictions to the investment activity of each investment fund, which are based on the type and legal structure of each investment fund (AIF, open-ended or closed-ended fund) as well as the kind of investors investing therein (professional or retail). Therefore, each type of investment fund is prevented from participating in a private equity transaction if such transaction is not allowed by the applicable legal framework.

In addition to the foregoing, Italian and European antitrust provisions provide for further limits to the investment by private equity funds in certain businesses if such investments result in an abusive behaviour or a violation of the market concentration limits. As for the limits with respect to non-European private equity funds and managers, see question 27.

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32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Remuneration and profit-sharing arrangements of professionals performing administrative, management and supervisory functions within fund managers or sponsors are subject to specific limits and criteria that are mostly derived from certain general principles set forth in European regulations (specifically arising out of the guidelines on sound remuneration related to the AIFMD issued by the European Securities Market Authority). In particular, fund managers' and sponsors' compensation policies and profit-sharing arrangements are required to be consistent with and proportional to the nature and size of the managed private equity fund, in addition to the following:

- complying with the risk strategies of the investment fund;
- being in line with the levels of capital and liquidity of the investment fund; and
- being structured so as to prevent or minimise possible conflicts of interest.

Compensation policies shall be approved by the shareholders of the fund managers and take into account the performance and financial results of the managed investment funds. Generally, a specific corporate body of the fund manager acts as a remuneration committee and is responsible for the structuring of the remuneration policy (consisting in both cash and financial instruments). The above-mentioned limits on fund managers' compensation and profit-sharing arrangements do not generally apply to managers that fall within the AIFMD's definition of below-the-threshold fund managers.

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Japan

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In Japan, a limited partnership formed under the Act concerning Investment Business Limited Partnership Agreements (the AIBLPA) (Act No. 90 of 1998) is the most typical vehicle for private equity funds. A limited partnership does not have a separate legal personality from its partners; therefore, the partners are deemed to hold the assets and liabilities of the partnership directly. Usually, an investor becomes a limited partner, whose liability is limited to the amount of its capital contribution, unless otherwise agreed, and the manager becomes, or has its affiliate become, the general partner of the partnership.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

To form a limited partnership, a general partner must execute a limited partnership agreement, in writing, with at least one limited partner. In rare instances in Japan, a short-form agreement with a nominee limited partner for formation is used, which is later replaced with an amended and restated agreement upon negotiation and documentation with the initial investors. Therefore, the length of time required for formation depends on the offering activities for fundraising and documentation with the initial investors. Once the general partner executes the limited partnership agreement, it has to register the limited partnership with the relevant local legal affairs bureau within two weeks of the execution. A registration tax of ¥30,000 is imposed for the initial registration. The general partner may file the registration documents themselves, or through an attorney. The registration will be completed within one week or so, upon filing. Under the AIBLPA all the partners are required to make capital contributions to the limited partnership, but there are no minimum capital requirements.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Under the AIBLPA, the limited partnership needs to have a registered office in Japan. The general partner must prepare financial statements, request that a certified auditor audit the statements within three months of the end of each business year and maintain a copy of the audited financial statements, together with a copy of the partnership agreement and the auditor's opinion, at the principal office for a period of five years. Limited partners and creditors to the limited partnership may ask the general partner to allow them to review those documents. The general partner may have to retain a custodian under the Financial Instruments and Exchange Act (FIEA) in order to meet the asset-segregation requirements in connection with its licence or offering activities. There are no requirements for an administrator or a corporate secretary.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

A general partner must register the following information with a local legal affairs bureau within two weeks of the limited partnership agreement becoming effective:

- the business purpose of the limited partnership;
- the name of the limited partnership;
- the date when the limited partnership agreement became effective;
- the duration period of the limited partnership;
- the name and location address of the general partner;
- the location of the office of the limited partnership; and
- any additional dissolution events of the limited partnership that are not set forth under the AIBLPA.

When any information changes, the general partner must register the changed information within two weeks of the change occurring. If the general partner fails to file within this deadline, it may be subject to a monetary penalty of ¥1 million or less. Anyone may request that the registry issue a certified copy of the registered information, and may also access the information through the website, but information regarding the identities of the investors or the amount of their capital commitment is not publicly available.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Generally, the limited liability for third-party investors is respected under the AIBLPA. However, if a limited partner has misled a third party to believe that it has the power or authority to execute the business on behalf of the limited partnership, it shall owe the same responsibilities as the general partner with regard to such third party who entered into a transaction with the limited partnership on the basis of such misunderstanding.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Under the AIBLPA, a general partner owes a 'duty of due care of a prudent manager' to the limited partners of the partnership. This duty, according to the prevailing interpretation thereof, requires the degree of care that a prudent and competent person engaged in the same line

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of business or endeavour would exercise under similar circumstances. If the general partner fails to exercise such due care, it may be liable to compensate the limited partners for the damages resulting therefrom. Upon agreement with the limited partners, it may modify the scope or extent of such duty, but may not remove such duty entirely. Note, however, that if the general partner assumes its role as a financial instruments business operator (FIBO) who engages in the discretionary investment management business or if the general partner relies on the qualified institutional investor (QII) business exemption (as referred to below), the FIEA expressly imposes on the general partner the duty of due care of a prudent manager and a duty of loyalty to the limited partner, as well as various other regulatory obligations and restrictions. In such an instance, it may not modify the duties to be inconsistent with such regulations.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Japan recognises the gross negligence standard of liability in general, and upon agreement with the limited partners, a general partner may adopt such standard applicable to the management of a private equity fund.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The AIBLPA stipulates certain investment restrictions. A general partner may not invest the assets of the partnership into assets other than those listed under the AIBLPA. The AIBLPA covers almost all asset classes that private equity funds typically invest in, but a limited partnership is subject to a certain portfolio test if it wishes to invest in non-Japanese corporations. It may hold equity interests, warrants, and debts issued by non-Japanese corporations only if the total amount of the investments in non-Japanese corporations does not exceed 50 per cent of the total partnership assets.

Also, the offering activities of the interests in a limited partnership and the investment management activities are generally subject to the regulations under the FIEA. Therefore, unless respectively exempted thereunder, a general partner would have to obtain a business licence to conduct both activities in Japan, file the securities registration statement, prepare and deliver the prospectus to the investors for the public offering of the interests and continue the timely disclosure after the offering thereunder. In the usual cases, however, a general partner will comply with the requirements of the relevant exemptions, to avoid both licence requirements and public disclosure requirements.

Neither conversion nor redomiciling to limited partnerships in Japan from those of other jurisdictions is allowed.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Unless otherwise specifically provided for in the limited partnership agreement, events affecting the fund sponsor's status such as bankruptcy, insolvency, change of control or restructuring will not trigger dissolution of the fund or removal of the general partner. Provided that, only if the sponsor is the sole general partner and becomes bankrupt, the limited partnership shall be dissolved, unless the other partners find a new general partner within two weeks, under the AIBLPA.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Unless exempted under the FIEA, the general partner is required to register him or herself as a FIBO that engages in offering fund interest (Type II business) or discretionary investment management business. The Financial Services Agency (FSA) or the local financial bureaus (LFBs) are the principal regulatory bodies over a general partner of the fund. If a general partner registers itself as a FIBO, the FSA or the LFBs have broad power and authority to audit and inspect this general partner. It is also required to regularly provide investment management reports to investors and submit annual business reports to the relevant LFB, although they also are required to follow other continuous reporting requirements.

As a matter of practice, however, most of the general partners rely on the exemption from the above business licence requirements by satisfying certain conditions under article 63 of the FIEA (the QII business exemption) (see question 24 for the conditions of such exemption). Even in such a case, the FSA or the LFBs maintain the right to monitor and inspect such general partners, but it is not on a regular basis. Such general partners are required to file and update certain matters with the LFBs. Such general partners must comply with certain conduct requirements equivalent to a FIBO, and they may be required to regularly provide investment management reports to investors in connection with the status of investors. Such general partners must prepare and maintain records on their business, and must prepare and submit an annual business report to the LFBs, and must make some parts of their business reports available to the public at their relevant offices or on their website.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

As opposed to a corporate-type fund or unit trust, partnership-type funds do not need be registered under the mutual fund law of Japan. However, if the interests are publicly offered in Japan, the general partner has to file the securities registration statement, prepare and deliver the prospectus to the investors, and conduct the ongoing disclosure under the FIEA. In connection with the FIEA, the location of significant investment activities does not make any difference in the application thereof.

See question 10 regarding the licence requirements for the general partner.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

See question 10 regarding the licence requirements for general partners. Once a general partner is registered as a FIBO on an entity basis, the officers or directors do not need to obtain a separate licence (their information is included in the FIBO application documents of the general partner). They may conduct their business as personnel of the licensed FIBO. A control person will, as the case may be, be required to file another report of its shareholding of the licensed FIBO under the FIEA.

There is no such registration requirement if the general partner relies on the QII business exemption (the information regarding the officers or directors is included in the notification (Form 20) to be filed by the general partner), although the requirement to report a control person is not applicable.

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13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

If the general partner registers as a FIBO that engages in discretionary investment management, it must satisfy the following requirements for the registration:

- its permission, approval or registration necessary for financial instrument business or other business under the FIEA or other equivalent non-Japanese laws has not been rescinded within the preceding five years;
- it has not violated the FIEA or other laws, and has not been subject to a fine within the preceding five years;
- it has not engaged in business contrary to the public interest;
- it has sufficient staff to properly conduct financial instrument business;
- it has ¥50 million in stated capital or in total equity;
- it is either a Japanese corporation with a board of directors, or a foreign corporation equivalent thereto;
- it has net assets of at least ¥50 million;
- it does not engage in such business (other than permitted business under the FIEA) that it cannot properly control the risk;
- none of its directors, officers, others who have power to manage it, fund managers or compliance officers fall into any of the excluded categories under the FIEA; and
- if it is a Japanese corporation, none of its major shareholders fall into any of the excluded categories under the FIEA; if it is a non-Japanese entity, the authorities in its home jurisdiction confirm that the solid and appropriate operation of its financial instrument business will not be prevented by any major shareholders.

If the general partner relies on the QII business exemption, it must satisfy the following requirements (see question 24 for further conditions of such exemption):

- its permission, approval or registration necessary for financial instrument business or other business under the FIEA or other equivalent non-Japanese laws has not been rescinded within the preceding five years;
- it has not violated the FIEA or other laws, and has not been subject to a fine within the preceding five years;
- none of its directors, officers, others who have power to manage it, fund managers or compliance officers fall into any of the excluded categories under the FIEA;
- if it is a non-Japanese person, any foreign regulatory authority in the jurisdiction where the general partner domiciles or is operating has signed the International Organization of Securities Commissions Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, or an equivalent bilateral agreement with the Japanese government; and
- if it is a non-Japanese person, it must appoint a representative in Japan.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

In Japan, no one may accept contributions for political activities from a non-Japanese person or a Japanese entity whose equities are mainly held by a non-Japanese person. Other than this restriction, a general partner may make political contributions, which are in principle disclosed to the public.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There is no such restriction or requirement under Japanese law. We have not found any such internal rule or policy of public pension plans or governmental entities, based on publicly available information.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

This is not a recent legal development, but owing to the voting equity holding restriction applicable to banking entities, a Japanese bank would hesitate to hold more than a 5 per cent interest in a partnership-type private equity fund unless specifically exempted thereunder. In the case of a limited partnership under the AIBLPA, a bank may rely on the exemption if certain conditions are met, but usually requests that the general partner make further covenants to ensure its compliance with such regulations.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Under Japanese tax law, a limited partnership is itself a non-taxable entity, and income or gain arising from investment through the partnership will be allocated to each partner without imposition of a tax at the limited partnership level. All distributions made by the limited partnership to foreign investors (if they maintain a permanent establishment in Japan) are generally subject to a withholding tax at the rate of 20 per cent. Other than this, neither the limited partnership nor the general partner is required to withhold taxes regarding distributions to partners.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

According to a tax authority ruling, investment activities conducted by a general partner on behalf of a limited partnership are generally deemed to be activities jointly carried out by all partners of the partnership. Based on this idea, when a non-Japanese investor becomes a limited partner of a limited partnership, the investor is deemed to have a permanent establishment in Japan so that all investment income derived from the partnership is subject to Japanese taxation if at least one general partner of the limited partnership is a Japanese resident. Therefore, all distributions made by the limited partnership to foreign investors are generally subject to taxation in Japan. However, there is a statutory exemption, under which a foreign investor as a limited partner of a limited partnership is deemed to have no permanent establishment in Japan. In such cases, distributions made to the limited partner (that would otherwise be subject to taxation because of a permanent establishment) will not be subject to withholding tax in Japan and no obligation to file a Japanese tax return is imposed. To rely on the exemption, a foreign investor who satisfies all of the following requirements must file an application with the Japanese tax authorities via the general partner stating:

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- it is a limited partner;
- it does not engage in business operations or management of the limited partnership;
- it does not hold 25 per cent or more of the whole of the partnership interests;
- it does not have any close capital relationship with the general partner; and
- it has no permanent establishment in Japan other than by virtue of having invested in the partnership.

Under Japanese tax law, even if a non-Japanese resident investor does not have a permanent establishment in Japan, when a non-Japanese resident investor possesses 25 per cent or more of the total issued shares of a Japanese corporation at any time within three years prior to the last day of the business year containing the date of transfer, and the investor transfers 5 per cent or more of the total issued shares, the transfer of shares is taxable in Japan (the 25 per cent/5 per cent rule). In calculating these ratios, the number of shares held or transferred by specific persons related to the investor is aggregated, and when the non-Japanese resident investor invests in a limited partnership which invests its partnership assets into shares of Japanese corporations, other limited partners of the limited partnership fall into the category of specially related persons. If, however, a non-Japanese resident investor that is a limited partner in a limited partnership satisfies certain conditions, it may exclude other partners' shares to calculate the 25 per cent/5 per cent rule. This exemption applies when the non-Japanese resident investor satisfies the following requirements:

- either the limited partnership is one to which the previously discussed exemption applies, or during the relevant three-year period, the non-Japanese resident investor was not involved in the conduct of the operations or management of the limited partnership;
- at any time during the three-year period, no specially related person (other than other limited partners) of the non-Japanese resident investor held 25 per cent or more of the interest of the domestic company;
- the limited partnership held the relevant shares for at least one year;
- the investment target is not a proscribed type of insolvent financial institution; and
- the non-Japanese resident investor files certain documents with the Japanese tax authorities by 15 March of the following year (for an individual investor) or two months after the fiscal year-end (for a corporate investor).

Besides the above, capital gains resulting from any of the following share transfers are subject to Japanese tax unless otherwise exempted:

- the transfer of shares in a Japanese corporation by conducting certain market manipulations or greenmail activities against the Japanese corporation; and
- the transfer of more than 2 per cent (in the case of the listed shares, 5 per cent) of the shares in a corporation that derives 50 per cent or more of the value of its gross assets directly or indirectly from real estate (including related rights over real estate) in Japan by the non-Japanese resident investor and other specially related shareholders.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

There is no special necessity to obtain a ruling from the Japanese tax authorities.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

To register the formation of a limited partnership, ¥30,000 must be paid as a registration tax.

Update and trends

Since 1 March 2016 the amended FIEA has greatly increased the regulatory burden of a general partner who relies on the QII business exemption. Some of the regulatory burdens are on a similar level to a licensed FIBO engaging in Type II business and investment management business. See question 24 for the conditions of this exemption.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

On the assumption that the general partner is a corporate entity (as opposed to an individual), there are no special considerations regarding carried interest and management fees from the viewpoint of Japanese taxation.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Japan has entered into a number of tax treaties, and how those treaties apply to a specific fund vehicle or its partners depends on the specific facts, including the structure of that fund vehicle and the residence of the relevant parties.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

As with many other jurisdictions, the tax rules in Japan are complex and intricate. Nevertheless, tax matters occupy an important position in fund structuring, and we highly recommend that tax advisers are consulted with regarding the specific fund structure and investment.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

In connection with the private placement exemption for marketing interests in partnership-type funds, fewer than 500 investors in Japan shall acquire the interests, and the investors shall be notified that the offer of the interests has not been or will not be registered on the ground that they are securities set forth in article 2, paragraph 2, item 5 of the FIEA and that the offer of the interests falls under the category of a small number private placement exemption. Further, if the general partner relies on the QII business exemption, it shall comply with, among other things, the following conditions:

- it has at least one QII limited partner;
- it has no investors other than QIIs or eligible non-QIIs;
- it has no more than 49 eligible non-QII limited partners;
- it has no disqualified investors listed in the FIEA; and
- it complies with the transfer restrictions, in which the QII may not transfer its interests to a person other than a QII and an eligible non-QII may not transfer its interests to more than one person who is a QII or an eligible non-QII.

A QII is defined in article 2, paragraph 3, item 1 of the FIEA. An eligible non-QII is listed in article 17-12, paragraphs 1 and 2 of the Order for Enforcement of the FIEA, which includes, among others, FIBOs, parent companies, subsidiaries and sister companies of a general partner and officers or employees thereof, listed companies, Japanese juridical persons with ¥50 million or more in stated capital or of net assets, foreign juridical persons, individuals who hold investment-type financial

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products equivalent to ¥100 million or more and opened securities accounts at least one year previously, and other certain persons.

In relying on the exemption, the general partner must file a notification (Form 20) with the relevant office of the LFB prior to any solicitation.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

As set forth in question 24, if a general partner relies on the QII business exemption, at least one limited partner shall be a QII, it may not accept a Japanese investor other than a QII or eligible non-QII and the number of eligible non-QII limited partners shall be 49 or less. Further, it may not accept a disqualified investor (such as certain special-purpose companies and certain funds of funds in which a non-QII invests).

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

If a general partner relies on the QII business exemption, it must specify each QII's name, and the name of the fund in the notification (Form 20) to, and be filed with the LFBs; however, QIIs' names are not publicly available. Also, the general partner is required to update the notification without delay (within one month) if any matter described therein is changed. Also, in connection with the registration with the legal affairs bureau, it must update any registered matter to be changed, within two weeks of the change being effective.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Unless otherwise exempted, a general partner or outside placement agents who offer fund interests are required to register themselves as a FIBO that engages in Type II business. However, if a general partner relies on the QII business exemption, such general partner does not have to register as a FIBO for offering their fund interests. See question 24 for the conditions of such exemption.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Act on Prevention of Transfer of Criminal Proceeds (APTCP) requires that a general partner who is registered as an FIBO or relies on the QII business exemption, before accepting a new investor, completes the investor identification process in accordance with the APTCP. At a minimum, the general partner must verify the identity of its investor prior to the execution of the subscription agreement with that investor and maintain records of the information used to verify the investor's identity. The general partner must promptly report to the regulatory authority if the general partner suspects that property received from an investor relating to its investment management business may be from criminal proceedings, or that an investor may have engaged in criminal conduct in connection with any transaction relating to its investment management business. The administrative guideline requires that the general partner avoid contact with 'antisocial forces'. An organised crime group, a member of an organised crime group, a quasi-member of an organised crime group, a related company or association of an organised crime group, a corporate racketeer and other equivalent groups are included in antisocial forces. The general partner shall not enter into any agreement with antisocial forces or entities controlled by antisocial forces.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Under the FIEA it is technically possible to list on a securities exchange, but no securities exchanges in Japan have rules that assume partnership interests are to be listed on the exchanges. Therefore, based on the current situation, private equity funds formed as partnerships are unable to be listed on securities exchanges in Japan.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

This is not applicable under the current exchange rules.

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Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Other than those described herein, there are no explicit legal or regulatory restrictions that a general partner should be concerned with when it establishes a limited partnership as an investment vehicle for private equity investments.

If the general partner retains a placement agent in Japan who is a FIBO engaging in Type II business or the general partner relies on the QII business exemption, it must make sure to segregate partnership assets from its own assets, in accordance with the FIEA. Also, in connection with the foreign exchange regulations of Japan, the general partner should ask its non-Japanese limited partners to file prior notification or a report of the acquisition of an equity share when the limited partnership acquires an equity share in a certain category of Japanese corporation, since such acquisition would be deemed to be direct investment by such non-Japanese limited partners of a part of the equity share, owing to the legal transparency of the limited partnership.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no specific issues regarding this topic.

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Korea

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Among the different types of funds that may be operated as private equity fund vehicles in Korea (including venture funds and small and medium-sized business investment funds, etc), the Financial Services and Capital Markets Act of Korea (FSCMA) sets out the basic requirements for establishing a private fund for management participation (PEF), which is the form used generally for most private equity funds in Korea, and is the type of private equity fund that is the subject of this chapter. PEFs established under the FSCMA use the *habjahoesa* legal form. A *habjahoesa* has following characteristics:

- a *habjahoesa* is a legal entity regulated under both the FSCMA and the Commercial Code of Korea. The FSCMA's provisions may, however, expressly override any otherwise conflicting general provisions of the Commercial Code with regard to some aspects of PEF formation and business or investment activities; and
- a *habjahoesa* has separate legal personality under the laws of Korea, but otherwise combines some limited partnership-type characteristics with corporate features.

The manager of a PEF is a general member (analogous to a general partner) of the PEF, and has unlimited liability in relation to the PEF's obligations (in this chapter, the general member will generally be referred to as the 'manager'). Investors (other than the general member) are limited members (analogous to limited partners) of the PEF and their liability exposure in relation to the PEF's obligations is limited to the amount of capital they have committed to the PEF. Although the manager of the PEF in principle has unlimited liability for the PEF's obligations, the FSCMA generally prohibits borrowing and debt-based financing by PEFs (see question 8). Accordingly, the liability of a PEF manager is somewhat limited in practice.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

To establish a PEF, the members must agree upon and execute the articles of incorporation of the PEF and the manager must register the PEF at the Commercial Registry.

Under the FSCMA, the articles of incorporation of a PEF must include the following basic contents:

- business purpose;
- name;
- location of office;
- amount of each member's capital commitment, method of contribution of each member (cash or in kind) and valuation method for in-kind contributions;
- duration (up to 15 years);
- any dissolution events other than the standard statutory events specified in the FSCMA and Commercial Code;
- name and identification number of each member;
- classification of each member (ie, general member or limited member); and
- execution date of the articles of incorporation.

Of course, the articles of incorporation of a PEF may include various other clauses, if desired by the members. The following contents of the articles of incorporation must be registered at the Commercial Registry:

- business purpose;
- name;
- location of office;
- duration;
- any dissolution events other than the standard statutory events specified in the FSCMA and Commercial Code;
- details of the manager (name, identification number, location of office); and
- date of establishment (the date on which the manager filed the PEF registration application to the registrar).

If there is any change in the registered information, the manager must cause the change to be entered into the Commercial Registry.

Upon establishment, the manager must file a PEF establishment report to the Financial Supervisory Service (FSS). The amount of information required in the PEF establishment report is fairly extensive and includes (but is not limited to) the following:

- name;
- business purpose;
- date of establishment;
- location of office;
- duration;
- any dissolution events other than the standard statutory events specified in the FSCMA and Commercial Code;
- number of all limited members and the number of limited members in each investor category (ie, professional investors and ordinary investors) (see question 26);
- details of manager (name, identification number, location of office, summary financial statement, commitment amount to PEF, major shareholders, list of directors or employees that will manage the PEF);
- total commitment amounts and the commitment amounts of each investor category;
- total contribution amount and the contribution amounts of each investor category;
- investment policy (if specified in articles of incorporation);
- investment target and investment strategy (if specified in articles of incorporation);
- details of investment purpose company (see question 8); and
- fees payable to the manager (including carried interest, if any).

If there is any change in the information stated in the PEF establishment report, the manager must report such change to the FSS.

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3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A PEF must hire a local custodian that is licensed as a trust company under the FSCMA and a PEF must have a registered office in Korea. Typically, the office of the manager is also used as the registered office of the PEF. The manager of the PEF is required to maintain the books and records of the PEF.

The manager may hire a local administrator that is licensed as an administrator under the FSCMA, but this is not a requirement.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The general public can access the Commercial Registry. As a result, anyone can access the following information on any PEF that is duly registered in the Commercial Registry (see question 2):

- business purpose;
- name;
- location of office;
- duration;
- any dissolution events specified in the articles of incorporation of the PEF in addition to those provided under the FSCMA and the Commercial Code;
- details of the manager; and
- date of establishment.

Other information, such as the identities of limited members and the amounts of their individual capital commitments, is not publicly available.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Generally, investment in a Korean PEF is restricted to the members (ie, general members and limited members). A limited member's liability exposure is limited to the extent of the limited member's capital commitment to the PEF. Unlimited liability may be imposed on a limited member, however, in cases where: the limited member has expressly or implicitly misrepresented itself as being a general member; and the relevant PEF creditor has entered into a transaction with the PEF owing to a misunderstanding caused by the limited member's misrepresentation.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Under the Commercial Code, the manager of a *habjahoesa* owes a general 'duty of care as a prudent manager' and 'duty of loyalty'. In Korean law, a person's 'duty of care as a prudent manager' is essentially a 'reasonable person' standard in a management context, meaning the duty of care that is ordinarily expected from similarly situated managers exercising reasonable prudence in carrying out management responsibilities.

The object of such duties is not expressly provided in the Commercial Code. Some commentators argue that the manager owes such duties to both the *habjahoesa* and its members, while other commentators argue that the manager owes such duty to the *habjahoesa* entity but not to the other members. In practice, many PEFs' articles of incorporation include an express obligation for the manager to indemnify both the company and other members against damage caused by the manager.

A review of court cases and the relevant statutory provisions does not produce a definitive statement as to whether fiduciary duties can be modified by a *habjahoesa*'s articles of incorporation. Moreover, the commentators do not discuss this issue. However, a reasonable analysis of certain provisions of the Commercial Code would appear to provide a sound basis for recognition of such modifications. More specifically, the Commercial Code expressly recognises that a *habjahoesa*'s articles of incorporation can override the provisions of the Commercial Code with regard to rights and obligations among the members of the *habjahoesa*. Accordingly, it is reasonable to conclude that if the articles of incorporation expressly modify the manager's fiduciary duties, such modification is likely to be upheld in the event of a dispute.

Such modification is not possible, however, in cases where the FSCMA explicitly sets out concrete provisions concerning the duty of loyalty of the manager of the PEF. The FSCMA prohibits managers from taking certain actions, including (but not limited to):

- engaging in transactions between the PEF and the manager itself, without consent of all other members;
- providing a list of PEF assets to third parties, without consent of all other members; and
- using information concerning PEF assets for the purposes of investing the manager's own assets.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

In Korea, a gross negligence standard of liability is generally recognised.

A review of court cases and the relevant statutory provisions does not produce definitive views as to whether the gross negligence standard can be applied with regard to the management of a PEF. Moreover, the commentators do not discuss this issue. However, the Commercial Code expressly recognises that a *habjahoesa*'s articles of incorporation can override the provisions of the Commercial Code with regard to rights and obligations among the members of the *habjahoesa*. This would appear to provide a sound basis for recognition of provisions in a *habjahoesa*'s articles of incorporation that purport to limit the scope of the manager's liability by applying a gross negligence standard instead of an ordinary negligence standard.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The FSCMA provides various restrictions on investment activities or transactions of PEFs:

(i) A PEF is generally prohibited from debt-based financing (borrowing funds) and from providing guarantees for any third-party debt. As an exception to this general prohibition, however, a PEF may, in limited circumstances, borrow money or guarantee the debt of an investment purpose company (IPC), as defined in the FSCMA. These exceptions apply in cases where:
   (a) a member has withdrawn and the PEF has insufficient cash for redemption;
   (b) the PEF experiences a temporary shortfall of operating capital; or
   (c) the PEF temporarily lacks the cash needed for investment into the target company.

   Even in such exceptional situations, the total amount of debt or guarantee obligations that may be incurred is limited to a level that is not more than 10 per cent of total net capital of the PEF. In contrast, the IPC can borrow money up to an amount equivalent to 300 per cent of its net capital. The purpose of these IPC-related provisions is to protect the manager from unlimited liability that would

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otherwise be incurred owing to its status as general member of the PEF. Consequently, establishment of an IPC is a necessary step for PEFs seeking to carry out leveraged buyouts.

(ii) The PEF can invest into one or more IPCs, provided that the PEF holds at least 50 per cent of the equity interests in any such IPC. With regard to the balance of equity interests of an IPC that are not held by the PEF, business entities that are mainly engaged in financial business activities, such as banks, brokers, dealers or other licensed funds, are as a general rule prohibited from being equity holders.

(iii) The PEF or IPC must invest into a target company only by way of:
- (a) acquiring 10 per cent or more of the target company's equity;
- (b) acquiring equity of less than 10 per cent and appointing one or more directors of the target company; or
- (c) acquiring mezzanine securities with the ultimate purpose of making an investment in the form of (a) or (b) above.

(iv) The PEF must invest at least 50 per cent of contributed capital directly, or indirectly through an IPC, within two years following the PEF's receipt of the contributed capital, in a target company or target companies in the manner described in (a) or (b) of (iii) above.

(v) When a PEF has invested into a target company in the manner described in (iii) above, it must maintain such investment for at least six months.

(vi) Although not expressly stated in the FSCMA, under the Financial Services Commission (FSC)'s interpretation of relevant FSCMA provisions, PEFs are prohibited from investing in Korean paper companies or shell companies (ie, any company that does not actually engage in any substantive business as a going concern). The FSC's interpretation does not prohibit Korean PEFs from investing in foreign paper companies or shell companies.

(vii) The FSCMA also regulates transfers of PEF interests. The interests of the manager may be transferred to a third party only pursuant to receiving the unanimous consent of the PEF members. The interests of a limited member may be transferred to a third party pursuant to receiving the manager's consent.

(viii) Conversion or redomiciling of foreign PEFs or collective investment vehicles to Korean PEFs or collective investment vehicles is not allowed.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Pursuant to the Commercial Code, the bankruptcy of a member is an automatic withdrawal event for such member. Additionally, the articles of incorporation of some PEFs include insolvency, change of control, restructuring or similar events with regard to a member as events that trigger automatic withdrawal for such member.

A limited member's withdrawal does not trigger the dissolution of the PEF. On the other hand, the manager's withdrawal does trigger the dissolution of the PEF, except in cases where a replacement manager joins the PEF.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Under the FSCMA, the FSC has ultimate regulatory authority over PEFs and their managers. For practical administrative purposes, however, nearly all of the day-to-day supervisory and regulatory operations are delegated to the FSS. The FSS has general inspection rights concerning the business activities and assets of PEFs.

The manager of a PEF must file various reports to the FSS:

- in principle, the manager must file an establishment report to the FSS within two weeks from the establishment of the PEF. In some extraordinary cases, such as where the capital commitments of affiliates of the manager constitute over 30 per cent of total capital commitments, the establishment report must be submitted immediately after establishment;
- further, if any subsequent change occurs with regard to the information contained in the establishment report, the manager must report such change to the FSS;
- the manager must file semi-annual reports to the FSS regarding the PEF's financial status. (Alternatively, such reports can be filed on an annual basis if the PEF's assets have a total value of less than 10 billion won); and
- the manager must file an investment report within two weeks after it has invested in a target corporation.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Before the 2015 amendment of the FSCMA, PEFs were required to be registered with the FSS. Subsequent to the amendment, no approval, licensing or registration requirements apply to Korean PEFs. The manager only needs to file an establishment report with the FSS.

Please note, however, that if the manager is not only licensed as a manager of a PEF, but is also licensed to operate as a financial institution, such as a broker, dealer, investment adviser, etc, the manager must obtain approval from the FSC regarding its planned capital commitment to the PEF, before the PEF is established.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Only Korean corporations that have been registered with the FSS can take on the role of manager of a Korean PEF. A natural person cannot be a manager of a PEF. For registration purposes, a corporation must satisfy a number of requirements, including (but not limited to) the following:

- the net capital of such corporation must be not less than 100 million won;
- the directors and regulatory auditor of such corporation must be qualified for such positions in accordance with the requirements set out in the Act on Corporate Governance of Financial Institutions;
- two or more employees or directors of the corporation must be dedicated to the management and administration of the PEF; and
- the corporation must have a satisfactory system of internal compliance rules in place.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

See the requirements listed in question 12. There are no other explicit requirements that apply to personnel of the manager who carries out the management of the PEF.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The Political Funds Act prohibits political contribution by an entity. Only a natural person may make political contributions. A manager of a PEF must be a corporation (see question 12) and it may not donate political funds. Further, the Political Funds Act prohibits political contributions by non-Korean natural persons.

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Otherwise there are no rules or policies of public pension plans or other governmental entities that restrict, or require disclosure of, political contributions by a general member's employees.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

The manager may hire other licensed dealers or brokers to carry out offers and sales of limited member interests and the identity of any such dealer or broker must be included in the establishment report (or any subsequent change report if the dealer or broker is hired after the PEF's establishment).

Otherwise there are no rules or policies of public pension plans or other governmental entities that restrict, or require disclosure concerning the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Some Korean banks that have one or more branches in the United States are subject to the US Bank Holding Company Act of 1956. Therefore such banks and their affiliates' investments into PEFs that invest in US companies may be restricted.

Under the Banking Act, a bank must acquire prior approval from the FSC if its capital commitment to a PEF constitutes more than 30 per cent of the total capital commitments of such PEF. However, this restriction is not necessarily a consequence of the recent global financial crisis.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

A PEF is considered a corporation for Korean tax purposes and is therefore subject to a corporate income tax in Korea. However, under article 100-15 of the Restriction of Special Taxation Act, a PEF may elect to be treated as a partnership for tax purposes. A PEF electing to be treated as a partnership does not have corporate income tax imposed at the entity level. Rather, the PEF's income is taxed at the level of the members at the time of the PEF's allocation. However, please note that even when a PEF has elected to be treated as a partnership, any income allocated to its members nevertheless should be treated as dividend income for the members.

A partnership is required to report its income and distribution return to the head of the competent tax office by the 15th day of the third month following the closing of the partnership's taxable year. A partnership must also apply withholding tax on income allocated to its non-Korean residents and foreign corporations and pay the amount withheld to the competent tax office by the 10th day following the day on which the partnership's report and distribution return is due (see above for the specific due date). The specific withholding tax rates are as follows:

- 22 per cent (including surtax) for limited members (however, subject to a reduced rate of withholding tax for limited members that are residents of a country that has an effective income tax treaty with the Republic of Korea); or
- graduated tax rate (6.6 to 44 per cent for non-resident individuals and 11 to 24.2 per cent for foreign corporations, as of 2017).

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors in a PEF would not be subject to a return-filing requirement or taxation thereof (other than the withholding tax mentioned above), if it does not have a permanent establishment in Korea.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

There is no notable tax treatment other than the ones mentioned in previous paragraphs.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There is no organisational tax imposed on a PEF upon its organisation.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

VAT exemption is afforded to services provided by the general member or manager to PEF, such as services relating to the operation, management, or holding of PEF property, sale or redemption of the PEF's equity, etc.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The Republic of Korea has an income tax treaty in effect with more than 90 countries, and investment vehicles are usually not considered as resident for treaty purposes. Please also note that the Overseas Investment Vehicle (OIV) regime was introduced into the Korean tax law as a procedural mechanism to claim tax treaty benefits in 2012 for reduced withholding tax rates, and 2014 for capital gains tax exemption. An OIV is broadly defined as an overseas vehicle that raises funds through an investment offering, manages investment assets, derives value from the acquisition and disposition of such assets, and distributes such derived value to its investors. Under the OIV regime, the respective OIVs may be looked through for withholding purposes in applying the relevant reduced withholding rate under the relevant tax treaty.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Because of the dividend income treatment for allocations made by PEFs (regardless of the character of income when received by the PEF) under Korean tax rules, a discrepancy arises in terms of income characterisation when a transaction relates to a direct investment from or by a foreign investor.

To partially resolve this problem, the Korean legislature has introduced a special rule applicable to certain foreign governmental agencies or pension funds investing in domestic PEFs as limited members, if such agencies or funds meet certain requirements. Under this regime, assuming the requirements are met, the character of income allocated to certain foreign governmental agencies or foreign pension funds is

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maintained for Korean withholding purposes despite the PEF's allocation (ie, the income character is not changed as dividends). However, please note that such special treatment is only afforded to limited types of entities.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

The FSCMA makes distinctions based on two investor categories: professional investors (as defined in the FSCMA); and ordinary investors. Essentially any investor that is not a professional investor falls into the ordinary investor category.

There is no limitation on the offers of PEF limited member interests to professional investors. But offers to more than 49 ordinary investors are restricted. In addition to this, a Korean PEF is not allowed to have more than 49 ordinary (ie, non-professional) investors as limited members.

Usually the offers and sales of PEF limited member interests are conducted by the manager. However, the manager may hire other licensed dealers or brokers to conduct offers and sales of limited member interests.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There is no limitation on the capital commitments of professional investors. Ordinary investors, on the other hand, must commit more than 300 million won. This restriction is intended to protect ordinary investors who are not wealthy or sophisticated investors from PEF investment risks.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Generally, if there is any change to the information submitted in the PEF establishment report, the manager must file a change report to the FSS (see question 10). The identity of each investor and the capital commitment of each investor are not required to be included in the establishment report. On the other hand, the following must be included in the report:

- the total number of investors;
- the number of members that are in each investor category (ie, professional investor or ordinary investor);
- the aggregate capital commitment amount of all investors in each investor category; and
- the aggregate contribution amount of all investors in each investor category.

Additionally, with regard to investors falling into the professional investor category, the types of entities must be indicated. In other words, the report should indicate the number of pension funds, licensed commercial funds, and other sub-categories of professional investors that are participating as investors in the PEF. For the ordinary investor category, an indication of whether the relevant investors are natural persons must be included. In both cases, the specific identities of the investors do not need to be included in the report. With regard to the manager, the ownership/control structure and management structure of the manager must be disclosed in the establishment report.

Accordingly, a transfer of fund interests will usually require a filing by the manager.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

As described in question 24, the registered general member of the PEF itself may offer and sell interests of the PEF, and it may engage a licensed dealer or broker. But it may not engage another person or entity that is not licensed as a dealer or broker.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Under the Act on Report and Utilisation of Certain Financial Transaction Information (the RUCFTI Act), financial institutions (as defined in the RUCFTI Act) are required to perform due diligence corresponding to know-your-customer and anti-money laundering rules of other major jurisdictions. However, a PEF's manager is not included per se in the RUCFTI definition of financial institutions and is not subject to the due diligence duties.

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Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

A Korean PEF is a privately placed fund and the interests of a PEF cannot be transferred freely (see question 8). Consequently, a Korean PEF cannot be publicly listed on a securities exchange in Korea.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Listing is not possible. See question 29.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

See question 8.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no legal or regulatory issues that would affect the structuring of the manager's compensation and profit-sharing arrangements with respect to the PEF. But such arrangements must be included in the PEF articles of incorporation.

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Luxembourg

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

When opting for Luxembourg as their investment hub, initiators (or promoters or sponsors) generally opt for either a non-regulated ordinary commercial company (Soparfi) or for one of the following fund regimes:

- an investment company in risk capital (SICAR), based on the law of 15 June 2004, as amended, on the Investment Company in Risk Capital (SICAR Law) (the SICAR is a vehicle specifically dedicated to private equity and venture capital investments, whether diversified or not); or
- a specialised investment fund (SIF), based on the law of 13 February 2007, as amended, on Specialised Investment Funds (SIF Law); or
- a reserved alternative investment fund (RAIF), based on the law of 23 July 2016 on reserved alternative investment funds (RAIF Law).

Although the SIF Law does not prescribe any quantitative, qualitative, geographical or other type of investment restrictions, the Luxembourg Supervisory Commission of the Financial Sector (CSSF) has issued a circular (Circular 07/309), pursuant to which a SIF should generally not invest more than 30 per cent of its assets or commitments in securities of the same kind issued by the same issuer. Certain exemptions may apply to this rule (eg, in the case of a feeder fund structuring). While it is not subject to any direct regulatory approval or supervision, it is generally considered that a RAIF must comply with similar diversification rules. To the extent such restriction makes the SIF and the RAIF incompatible with non-diversified private equity investments strategies, an initiator would instead either opt for the Soparfi, taking advantage of a flexible and efficient fiscal and legal framework, for the SICAR, or for the RAIF with a corporate object restricted to investment in risk capital assets (within the same meaning as for SICARs), in which cases no diversification requirements apply.

The Soparfi and the SICAR can only be formed as a corporate form having a legal personality separate from that of their investors (except if the Soparfi or the SICAR is established as a special limited partnership (SCSp) that does not have legal personality), whereas the SIF and the RAIF may, as referred to above, in addition be organised as an FCP (see later in this question) managed by a Luxembourg-based management company. It is important to stress that the Soparfi, SICAR, SIF and RAIF acronyms do not refer to specific legal forms, but merely to a specific set of legal, regulatory and tax provisions, with the actual investment vehicle or entity being formed as one of the following:

- a public limited liability company (SA);
- a private limited liability company (SARL);
- a partnership limited by shares (SCA);
- a cooperative company in the form of a public limited liability company (Coop-SA);
- a common limited partnership (SCS);
- a special limited partnership (SCSp); or
- solely in respect of the SIF and the RAIF, an FCP.

The SCA, SCS, SCSp and FCP deserve special attention. The SCA, SCS and SCSp are formed by agreement between one or several general partners with unlimited liability and general management powers, together with limited partners who participate in any profits and share in any losses, generally pro rata with their participation in the partnership and up to the amount of their commitment or contribution, as the case may be. Unlike the SCSp, which does not have legal personality, the SCA and SCS have full legal capacity distinct from that of their partners. The SCA, SCS and SCSp will further allow the initiator to structure the acquisition vehicle by using common law-style partnership concepts, well known to the international investor and initiator base. The SCS and SCSp can implement capital account mechanisms which are customary for common-law limited partnerships. Under this mechanism, each limited partner has typically an account reflecting its contribution to the partnership, which is adjusted over time to reflect its participation to profits and losses of the partnership. This mechanism does not require the issuance of securities of any kind to the limited partners. The full significance of the limited partnership as an investment vehicle can be further appreciated when looking at its fiscal treatment (see questions 17–23).

The FCP is similar to a unit trust in the UK or a mutual fund in the US. It is organised as a co-proprietorship whose joint owners are only liable up to the amount they have committed or contributed. The FCP does not have a legal personality and must be managed by a Luxembourg-based management company.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

A Soparfi, SICAR, SIF or RAIF may be formed within a relatively short period of time. While the Soparfi and the RAIF do not require any regulatory approved incorporation, SICARs and SIFs require prior CSSF approval before being allowed to do business. Upon completion of the regulatory review, both the SICAR and the SIF will be registered on an official list of regulated investment vehicles maintained by the CSSF.

As a general rule, the investment vehicle will come into existence when its articles of association or the partnership agreement (of the Soparfi, the SICAR or the SIF) are approved in front of a Luxembourg notary public, although SCS and SCSp may also be formed under private seal. The SIF in the form of an FCP will come into existence upon the execution of its management regulations. The incorporation deed – or an excerpt thereof for the SCS, the SCSp and the FCP – will be thereafter filed with the Luxembourg Register of Commerce and Companies (RCS) and published in the Luxembourg official electronic platform of central publication in respect of companies and associations (RESA) (for the FCP, an excerpt of registration of the signed management regulations with the RCS will be published). The formation of a RAIF shall be recorded in a notarial deed within five business days from its constitution. Within 15 business days from such notarial deed, a notice in respect of the RAIF's formation, with an indication of the RAIF's alternative investment fund manager (AIFM), shall be filed with the RCS with a view to being published in the RESA. RAIFs must be registered on a list held by the RCS within 20 business days of their formation.

The formation costs will comprise the notarial fees, the registration duty as well as publication costs. The minimum share capital amounts to €12,000 for a Soparfi in the form of a SARL and to €30,000 for an

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SA or SCA. In addition, SICARs must have a minimum capitalisation of €1 million (including any issue premium), while SIFs and RAIFs must have a minimum capitalisation of €1.25 million (including any issue premium), to be reached within 12 months of the official CSSF registration. The SICAR, SIF and RAIF may, furthermore, have a variable capital structure whereby their capital will at all times be equal to their net asset value.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

In accordance with Luxembourg law, a SICAR, SIF or RAIF must have its registered office and head office (central administration) in Luxembourg. Luxembourg company law follows the real seat theory (versus the incorporation theory) whereby any company maintaining its central place of administration in Luxembourg becomes subject to Luxembourg law.

All investment regimes (Soparfi, SICAR, SIF and RAIF) may either be self-administered (by renting their own premises and possibly hiring staff, for example) or enter into a domiciliation (and administration) agreement with a third-party service provider. With Luxembourg being Europe's largest fund administration centre, a large selection of service providers will be available to the fund's initiators. The cost of these services (including a fund's ongoing maintenance costs) and the level of substance required to be kept in Luxembourg will have to be assessed on a case-by-case basis. The SICAR and the SIF will have to pay, in addition, an annual registration fee to the CSSF.

SICARs, SIFs and RAIFs must appoint a Luxembourg-based depositary bank or the Luxembourg branch of a foreign credit institution to safeguard their assets, with the objective being a higher standard of protection for investors. In carrying out its duties, the depositary must act independently and solely in the interests of the investors. The depositary shall be liable in accordance with Luxembourg law towards the SICAR, SIF or RAIF and to their respective investors for any loss suffered by them as a result of the depositary's wrongful failure to perform its obligations or its wrongful improper performance thereof.

Under the law of 12 July 2013 which has implemented Directive 2011/61/EU of the European Parliament and the Council on alternative investment fund managers (AIFMD) under Luxembourg law (AIFML or AIFM Law), it is expressly required that AIFMs have to appoint a depositary for each alternative investment fund (AIF) they manage (irrespective of whether the AIF is a non-regulated ordinary commercial company, or set up under the SICAR, the SIF or the RAIF regime). Such depository shall either be a credit institution, an investment firm or another category of institution eligible to act as depositary under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. In respect of AIFs, which have no redemption rights exercisable during a period of five years from the date of the initial investments and which, in accordance with their investment policy, do not invest in financial instruments or invest in issuers or non-listed companies in order to potentially acquire control, the AIFM Law has embraced the option offered by the AIFMD to expand the scope of eligible depositaries. The AIFM Law has created the status of 'depositary of non-financial assets' under the law of 4 April 1993 on the financial sector (Banking Law), which can act as depositary in respect of those AIFs (irrespective of whether those AIFs are established as SICARs, SIFs, RAIFs or non-regulated commercial companies).

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Access to information is generally limited to what is disclosed in the formation deed in the RESA. This generally includes, but is not limited to, the identity of the founding shareholders or partners, the initial subscribed share capital, as well as information on management and shareholders' or partners' meetings. SICARs, SIFs and RAIFs set up with a variable capital structure will not disclose the identity of further subscribers in the event of additional subscriptions. If the SICAR, SIF or RAIF is formed as a SARL with fixed capital, the identity of its shareholders and the number of shares held by them will be published in the RESA and also publicly available at the RCS. As per the reform to the partnership legislation under the AIFM Law, the identity of the limited partners of an SCS are no longer published in the RESA. The same goes for the newly created SCSp. In both instances (SCS and SCSp), only an extract comprising the following information will be published in the RESA:

- the identity of the general partners;
- the corporate denomination of the SCS or SCSp;
- its corporate object and registered office;
- the name of its managers and their signatory powers; and
- the term of the SCS or SCSp (inception and termination date).

Disclosure obligations are therefore rather limited. Luxembourg company law provides for a series of sanctions in the event mandatory information is not made available by publication in the RESA. Certain documents and extracts of documents will only be binding towards third parties as from the day of their publication in the RESA, unless the company proves that the relevant third parties had prior knowledge thereof. Third parties may, however, rely upon documents or extracts thereof that have not yet been published. For transactions taking place before the 16th day following the day of publication, these documents or extracts of documents will not be binding towards third parties who can prove that it was not possible for them to have knowledge thereof. In the event of a discrepancy between the document filed and the document published in the RESA, the latter is not binding toward third parties unless the company can prove that they had knowledge of the contents of the document filed.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The corporate veil may only be pierced in very limited circumstances where, for example, there has been a mingling of the assets of the partners or shareholders and the assets of the entity, creating a false perception in the mind of third parties. In relation to investment vehicles formed as an SCA, SCS or SCSp, the involvement of limited partners in acts of management towards third parties could potentially put their limited liability at risk. Managers and directors could also under certain circumstances also be held liable. In relation to limited partners' liability, the AIFM Law has introduced a list of permitted management acts which, if carried out by limited partners, would not trigger the loss of their limited liability. While exhaustive, the list is wide ranging and covers the following:

- the exercise of partners' rights under the limited partnership agreement;
- any advice given by the limited partners to the SCA, SCS or SCSp;
- any supervisory authorisation powers given to limited partners under the limited partnership agreement; and
- the granting of loans-security arrangements to the SCA, SCS or SCSp.

Limited partners may also act as manager of the relevant partnership and represent it on the basis of a proxy without losing their limited liability status.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Appointed managers and directors will be liable toward the investment entity, in accordance with general civil law principles, for the execution of the mandate entrusted to them and for any misconduct in the management of corporate affairs. They shall be jointly and severally liable both towards the Soparfi, the SICAR or the SIF and any third parties for

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damages resulting from a violation of the Luxembourg law of 10 August 1915, as amended, on commercial companies (Company Law) or the articles of association of the relevant entity.

The fiduciary duties of the directors and managers of Luxembourg companies will be governed by the same minimum duty of care standard to act as a 'bonus paterfamilias' in similar circumstances for the execution of the mandate that has been entrusted to them. The constitutive documents of the entity may nevertheless provide for higher standards. It is debatable whether lower standards would be upheld by Luxembourg courts. In respect of SCA, SCS and SCSp, it should be pointed out that both internal management by one (or several) general partners or external management by a third-party manager are permitted. Liability status will differ in both instances. While the general partner of an SCA, SCS or SCSp is subject to joint, several and unlimited liability, a third-party manager will be liable in accordance with general civil law principles (as reflected above).

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Luxembourg law does not distinguish between 'gross negligence' and 'ordinary negligence', except that one's liability for gross negligence may not be validly limited or excluded.

Under Luxembourg company law, management is liable towards the company, in accordance with general civil rules, for the execution of its mandate and for any misconduct in the management of the company's affairs. Misconduct does not imply a fault on the part of the director, who may incur liability for his or her passive attitude, negligence or carelessness. Moreover, the Company Law provides for a joint and several liability of the directors towards the company as well as third parties for damages resulting from an infringement of the provisions of the Company Law or the articles of incorporation of the company.

In the case of bankruptcy, management and de facto managers of a company may be held personally, jointly and severally, or not jointly and severally, liable for all or part of the shortfall of assets over liabilities if they committed a manifestly serious fault that contributed to the bankruptcy of the company. The fact that this (serious) fault must be 'manifestly' serious seems to indicate a stricter standard of appreciation, namely that only a really strong, undisputable and unequivocal serious fault may give rise to this liability.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Luxembourg law allows the 'migration' or redomiciliation of foreign entities to Luxembourg with full legal and corporate continuity and thus their transformation into Luxembourg companies or partnerships, provided the jurisdiction of origin also allows the 'migration'. It is possible to change the corporate form of the entity upon migration or to keep the original legal form, provided that such form also exists (possibly with some adjustments) under Luxembourg law. The underlying corporate form to be adopted will thus be determined in the light of a variety of legal, fiscal or commercial considerations. It is also possible to transform a foreign entity into a SICAR, SIF or RAIF upon 'arrival' in Luxembourg, subject, in respect of a SICAR and a SIF, to the filing of a submission for regulation with the CSSF (containing all required documents). The migration will in some cases require the prior preparation of a valuation report to be draw up by an independent Luxembourg auditor and confirming that the minimum capitalisation required under Luxembourg law is reached. The scope of the adjustments will depend on the corporate form chosen upon entry in the Luxembourg legal sphere. If the initiator decides to set the redomiciled entity up as a SARL, its shares will be subject to statutory transfer restrictions. The initiator may decide to retain the SCA, SCS or SCSp as the legal regime to replicate the common law-type limited partnership. The SARL or the SCA corporate forms are often chosen for US tax reasons, as they are not considered as corporations per se. The SARL will not be open to more than 100 investors and may not offer its shares or beneficiary shares publicly. The latter limitation also applies to the SCS.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The bankruptcy or change of control of the initiator of a SICAR, SIF, RAIF or Soparfi does not per se affect the vehicle from a legal point of view. For a SICAR and a SIF, although there is no requirement for an initiator to be formally approved by the CSSF, good practice dictates that any change of control at the level of the initiator should be communicated to the CSSF. Under certain circumstances, investors in a SICAR, SIF or RAIF may have to be given the right to exit the vehicle. All of the aforementioned comments are made without prejudice to any provision included in the fund documentation to the effect of triggering a dissolution or removal rights at the fund level.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Questions 10 to 13 primarily address the SICAR, SIF and RAIF, the Soparfi escaping in principle regulation as long as it does not offer its securities to the public and does not qualify as an AIF under the AIFM Law. It also covers the implications of the AIFMD regime as implemented by the AIFML for each of those regimes.

SICARs and SIFs are always subject to prior authorisation and remain thereafter subject to the prudential supervision of the CSSF. The SICAR and SIF regimes apply upon formal election. The CSSF will verify that the SICAR, the SIF and their representatives comply with the applicable legal provisions and contractual arrangements. When submitting an application to the CSSF, the legal representatives of the SICAR and the SIF (namely, their managers or directors, or both), as well as their service providers (namely, the depositary bank, the administration agent, the register and transfer agent and the auditor) must demonstrate professional honour and sufficient experience. Any replacement is subject to the prior approval of the CSSF, although the managers and directors will not be required to register as investment advisers or otherwise in Luxembourg. The managers and directors of the SICAR and SIF will have to produce a detailed CV showing their track record and experience, and an extract from their criminal records as well as a declaration of honour to that effect clearing the applicant of any involvement in bankruptcy matters or other criminal acts.

The CSSF licence is further conditional on a show of evidence that the central administration of the SICAR or SIF is located in Luxembourg. The applicant thus needs to demonstrate that the main back-office operations (eg, accounting, subscription, the keeping of the shareholder register, redemptions, reporting, etc) are carried out in and from Luxembourg. The SICAR or SIF may, however, rely on the investment expertise of an investment adviser or manager established in another jurisdiction. Delegation of investment management functions is subject to specific conditions under the SIF law (including, prior notification to the CSSF; justification of the delegation structure by a more efficient conduct of business; and as far as portfolio or risk management functions are concerned, prior authorisation or registration of the delegate for the purpose of asset management (CSSF approval remaining possible in the absence of any such licence or registration)). Similar requirements are applicable to SICARs within the scope of the AIFML regime. It is important, furthermore, to note that the SICAR or SIF regimes are not applied selectively. Any initiator of whatever origin or

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qualification may thus apply for and organise a SICAR or SIF upon the satisfactory instruction of its application. Once authorised, the SICAR and the SIF will be entered into the official list maintained by the CSSF.

Both the SICAR and the SIF must comply with certain disclosure requirements. They must inter alia produce an issuing document (eg, in the form of a prospectus or private placement memorandum) and an annual report that they also need to communicate to the CSSF and to investors. These documents must include the information necessary for investors to be able to make an informed judgment on the proposed investment and the related risks. The annual report must be finalised within six months of the end of the financial period to which it pertains. Although the annual reporting obligations are in line with the common reporting obligations of commercial companies, neither the SICAR nor the SIF are subject to consolidated reporting.

The annual accounts must be audited, furthermore, by a certified Luxembourg independent auditor. The auditor is appointed and remunerated by the SICAR or SIF but will have to inform the CSSF about serious violations of the applicable legal provisions or about any facts or decisions that could potentially threaten the continuity of the SICAR or SIF.

A SICAR is invited to submit half-yearly financial information to the CSSF, including the following, at the least:

- a statement of the SICAR's financial situation and notably the total of its assets;
- a detailed account of its portfolio;
- the amount of the SICAR's subscribed and paid-up capital, as well as the total of investors' subscription commitments;
- information concerning the profile of the investors that subscribed to the SICAR's shares; and, where applicable
- information on the level of the SICAR's indebtedness.

A SIF is invited to submit yearly and monthly financial information to the CSSF.

Since the implementation of the AIFMD as per the AIFM Law, it should be noted that unregulated funds (any investment vehicle not subject to the supervision of the CSSF, potentially a Soparfi) could qualify as an AIF within the meaning of the AIFMD, and its manager be subsequently subject to registration or authorisation under the AIFM Law. An AIF is defined by the AIFMD as a collective investment vehicle, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and does not require authorisation under Directive 2009/65/EU (UCITS Directive). Being subject to regulatory supervision or authorisation is not a requirement to qualify as an AIF. The CSSF confirmed that it is the responsibility of the management body of the collective investment vehicle to self-assess if it qualifies as an AIFM and, hence, if it manages one or several AIFs. Assuming AIFs are being managed, then an AIFM licence shall be applied for should the AIFMD thresholds of assets under management be met. The standard threshold is set at €100 million, including assets acquired through the use of leverage but is increased to €500 million, when the portfolio of assets managed consists of AIFs that are not leveraged and have no redemption rights exercisable during a period of five years following the date of the initial investment in each AIF. The AIFM licence can be applied for either internally by the AIF itself (where the legal form of the AIF permits internal management) or by having recourse to a third-party AIFM (in Luxembourg or in another EU jurisdiction, pending the extension of the AIFMD passport to non-EU AIFMs).

It is of importance to note that while managers of sub-threshold AIFs are not subject to authorisation under the AIFM Law, they are not entirely exempted from the AIFM Law requirements. Those managers are required to register themselves with the CSSF, disclose the AIF they manage (and their investment strategies) and regularly report to the CSSF the principal instruments in which they trade and relating investment exposures. Managers of sub-threshold AIFs may nonetheless elect to subject themselves to the AIFM Law requirements (especially if they want to benefit from the EU passport attached to the licence).

Alongside non-regulated AIFs, the AIFML regime can also be applicable to SIFs and SICARs if they do qualify as AIFs and reach the applicable threshold of assets under management. In this context, the AIFML has amended the SIF and SICAR laws to establish two types of SIF and SICAR, namely those managed by an AIFMD-compliant manager and those managed by an AIFMD non-compliant manager.

Any AIFMD-compliant SICAR or SIF manager is subject to the following regime, which is the same as the general SICAR or SIF regime, with some exceptions:

- the CSSF may approve a SIF or SICAR whose central administration is not in Luxembourg if it has delegated its management to an AIFMD-compliant manager who performs the functions required by the AIFMD;
- the valuation rules contained in the AIFML will apply together with the current valuation rules contained in the SICAR Law or the SIF Law;
- the content of a SIF or SICAR's annual report must comply fully with the AIFML;
- the information to be communicated to the SIF or SICAR's investors must be in line with the AIFML requirements;
- the AIFML delegation rules will have to be complied with;
- it will benefit from the AIFMD marketing passport; and
- it must align its depositary regime with AIFMD requirements.

As far as the RAIF is concerned, although it is neither subject to any prior regulatory approval nor to any ongoing direct supervision, a RAIF is by virtue of the RAIF Law considered as an AIF, which is required to appoint an AIFMD-compliant AIFM and thus comply with all provisions of the AIFM Law.

In terms of reporting requirements, the AIFML contains obligations applicable to the manager of any AIF in scope. For SIFs and SICARs, those requirements will apply alongside the SIF or SICAR laws specific reporting rules which, to a large extent, have anticipated the AIFML reporting rules. The AIFMD reporting framework mainly consist in annual reporting and disclosure to investors and regulators requirements. Annual reports must be prepared at least once a year and within six months following the end of the financial year for each Luxembourg AIF managed or marketed in the EU. The annual reports will be audited and provided to investors upon request as well as to the CSSF. Disclosure to investors requirements entails communication of certain information prior to their investments (generally contained in an issuing document). Such information relates, inter alia, to the AIF's investment strategy and objectives, techniques it may employ and associated risks, the use of leverage and collateral and the procedures for issue and sale of shares or units. Further aspects that need to be disclosed are as follows:

- the AIF's valuation procedure and pricing methodology;
- a description of liquidity risk management and redemption arrangements;
- a description of all fees, charges and expenses and maximum amounts thereof, which are directly or indirectly borne by the investors;
- the policy on ensuring fair treatment of investors; and
- a description of any preferential treatment of investors.

In respect of reporting to the CSSF, a Luxembourg-based AIFM, should regularly report on the principal markets and instruments in which its AIFs trades and is required to disclose certain additional information encompassing, inter alia, the following:

- the percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature;
- any new liquidity management arrangements;
- the AIF's risk management systems;
- information on the AIF's main categories of assets; and
- the results of any stress tests.

Frequency of reporting is dependent on the threshold of assets under management.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

See question 10. The level of investment in Luxembourg is without bearing on applicable rules and regulations.

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12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

See question 10. While there is currently no registration or authorisation requirement for managers or directors of Luxembourg non-regulated investment vehicles, managers or directors of SICARs and SIFs must be authorised by the CSSF. The same approval requirement applies to Luxembourg regulated management companies of SIFs or RAIFs set up as an FCP. In practice, the Luxembourg-based management of a SICAR, SIF or RAIF delegates the investment advisory function, under its responsibility, to advisers located outside Luxembourg. While recourse to a third-party investment adviser is not subject to prior regulatory approval, delegation of investment management functions is subject to prior notification for any SIF and any SICAR falling in scope of the AIFMD requirements. Relevant AIFMD delegation requirements must be complied with (see question 10).

The law of 5 April 1993 (as amended) relating to the financial sector (Banking Law) provides for a special regulation of management companies of non-coordinated undertakings for collective investment whose activity consists in managing undertakings for collective investment other than those with a registered office in Luxembourg and other than coordinated undertakings for collective investment in transferable securities approved under Directive 2001/107/EC.

The Banking Law also requires Luxembourg-based investment advisers (other than management companies regulated under the law of 17 December 2010 on undertakings of collective investment) to be authorised as investment advisers under article 24 of the Banking Law.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

See question 10.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The amended law of 21 December 2007 on the Financing of Political Parties regulates contributions to political parties. This law provides that contributions to political parties by legal entities are forbidden and can only be made by natural persons. Natural persons must, however, provide their identity to the political party as anonymous contributions are not authorised. The identity of the contributors is recorded by the political party and a list of contributors and contributions amounting to more than €250 is filed together with the party's annual accounts.

Private equity fund managers, investment advisers or their employees who wish to make contributions to political parties are subject to this law. Therefore, their identity will be disclosed with the publicly available party's annual accounts, if the contribution is more than €250 or, for contributions in kind, if their value exceeds this threshold.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no specific rules governing the marketing of regulated or non-regulated private equity investment vehicles to public pension plans and other governmental entities. In relation to SICARs and SIFs the CSSF does, however, request information as to the means by which shares or interests issued by such vehicles are marketed or channelled to potential investors.

To the extent the relevant vehicle qualifies as an AIF, the applicable rules under the AIFM Law governing the marketing and distribution of AIFs will need to be complied with.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

As Luxembourg private equity investment structures usually attract international investors and local (Luxembourg) banks rarely act as investor or sponsor to such vehicles, it is likely that investment in Luxembourg private equity funds will be affected much more by internationally driven changes to European legislation and the legislation of foreign jurisdictions, such as the Basel III regulations providing for stricter capital requirements for banks as well as the US Dodd-Frank Act setting limitations on banks' investment in private equity funds, than by any changes to the domestic legislative framework.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

The analysis of the tax features of Luxembourg private equity investment vehicles requires a schematic approach. By and large, the available investment vehicles can be divided into vehicles that are in principle (if they are considered opaque) subject to general taxation rules on the one hand (Soparfi, SICAR or RAIF SICAR, as referred to below) and vehicles not subject to tax on the other hand (SIF or the standard RAIF). Within each category, we furthermore need to distinguish between entities that are fiscally opaque (SARL, SA and SCA) and those that are fiscally transparent (eg, SCS, SCSp or FCP).

Soparfi

A Soparfi, whether in the form of an SA, SARL or SCA, is an ordinary fully taxable commercial Luxembourg resident company subject to income taxation (namely, corporate income tax, municipal business tax, solidarity surcharge) on its worldwide income (combined rate for the city of Luxembourg in 2017 is 27.08 per cent. In 2018, the rate will be lowered to 26.01), subject to specific domestic or treaty exemptions, and indirect taxation (eg, VAT). However, exemptions apply as regards income and capital gains derived from qualifying participations (the participation exemption).

A Soparfi is also subject to a 0.5 per cent net wealth tax on its net asset value as of 1 January of each year (0.05 per cent tax rate for net assets whose value exceeds €500 million). Exemptions apply as regards, inter alia, qualifying participations. Soparfis are subject to a minimum net wealth tax ranging from €535 to €32,100 (depending on the size of their balance sheet). A Soparfi whose assets comprise at least 90 per cent of financial assets is subject to a minimum net wealth tax of €535 or €4,815 (depending on the size of its balance sheet).

Dividend distributions by a Soparfi are generally subject to Luxembourg dividend withholding tax at a rate of 15 per cent, although this rate may be reduced to zero by the application of Luxembourg double tax treaties or the exemptions provided under Luxembourg tax law (notably, Luxembourg's implementation of the Parent-Subsidiary Directive and, as of 1 January 2009, the withholding tax exemption available for certain shareholders that are resident in a country with which Luxembourg has a tax treaty in force and are subject to a corporate income tax considered as comparable to the Luxembourg one).

Liquidation surpluses distributed by a Soparfi to its shareholders are not subject to withholding tax in Luxembourg. Capital gains

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realised by non-resident shareholders are taxable only if they have held a significant shareholding (at least 10 per cent) in a Luxembourg company for less than six months.

SICAR

The SICAR can, generally speaking, be described as a tax-neutral vehicle for private equity investments.

Taxation of the SICAR – fiscally opaque

The SICAR regime for fiscally opaque entities (such as SA, SARL or SCA) follows the ordinary tax regime of the Soparfi with a few risk capital-specific adjustments. The SICAR is thus also subject to corporate income taxes and to specific domestic or treaty exemptions, and should qualify as a resident company for domestic and Luxembourg tax-treaty purposes. However, such type of SICAR benefits from a specific unconditional risk capital exemption to the extent that income from securities as well as income derived from the transfer, contribution or liquidation thereof (namely, bonds, shares, other transferable securities as well as negotiable instruments giving the right to acquire the aforementioned risk capital securities) benefits from an objective direct tax exemption. Temporarily invested idle funds may also benefit from this exemption, provided that these funds are effectively invested in risk capital investments within a 12-month period.

All other income is fully subject to ordinary Luxembourg direct taxation rules.

Fiscally opaque SICARs are exempt from net wealth tax. However, they are subject to a minimum net wealth tax in the same way as Soparfis.

Taxation of the SICAR – fiscally transparent

A SICAR formed as a fiscally transparent SCS allows for the replication of a common law-type limited partnership vehicle. Although the limited partnership has its own legal personality separate from that of its partners, it is itself not liable for direct taxation or net wealth tax in Luxembourg. The same applies to the SICAR formed as an SCSp with the difference that the SCSp has no legal personality of its own.

Taxation of distributions by the SICAR

The SICAR regime distinguishes itself from the rules applicable to Soparfis in that it always permits fiscally neutral (namely, without source taxation) profit repatriations: neither dividends nor liquidation proceeds distributed by a SICAR to investors are subject to withholding tax.

SIF

Generally speaking, the SIF is characterised by its tax neutrality:

- it is not subject to tax on income or capital gains;
- it is also not subject to net wealth tax; and
- distributions (including dividends and liquidation surpluses) made by a SIF to investors are not subject to withholding tax in Luxembourg.

However, the SIF is subject to an annual subscription tax of 0.01 per cent. The taxable basis of the subscription tax is the aggregate net assets of the specialised investment fund as valued on the last day of each quarter. Certain money markets and pension funds or SIFs investing in other funds, which are already subject to subscription tax, are exempt from subscription tax.

RAIF

RAIFs are also characterised by their tax neutrality. The default tax regime applicable to RAIFs mirrors the SIF regime. This means that the RAIF will only be subject, at fund level, to an annual subscription tax levied at a rate of 0.01 per cent of its net assets calculated on the last day of each quarter. Depending on the investment assets, some exemptions from subscription tax apply in order to avoid a duplication of this tax. Irrespective of the legal form chosen for the RAIF, it is not subject to corporate income tax, municipal business tax or net wealth tax, and distributions of profits by the RAIF do not give rise to a withholding tax.

However, RAIFs whose constitutive documents provide that their sole object is the investment in risk capital assets (the RAIF SICAR) are taxed according to the same tax rules as those applicable to SICARs.

Under these SICAR-mirroring tax rules, a RAIF SICAR that takes a corporate legal form (like the SA, SARL or SCA) is fiscally opaque and is a normally taxable entity for corporate income tax purposes, but with an exemption for any profits and gains derived from securities invested in risk capital (see above). Fiscally opaque RAIF SICAR are also exempt from net wealth tax but subject to a minimum net wealth tax (as SICARs).

Likewise, a RAIF SICAR that takes the form of a partnership (the SCS or SCSp) is tax transparent (see above).

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Soparfi

Unless a reduced rate under a double tax treaty or an exemption (either domestic or under a tax treaty) applies, dividends distributed by a Soparfi are subject to 15 per cent withholding tax. A non-resident investor is not subject to any tax reporting formality in this respect – it is the company that has to file a withholding tax return – unless the investor wants to effect any entitlement to a (partial or total) reimbursement of the withholding tax on dividends.

Non-resident investors are taxed in Luxembourg for the capital gains realised upon the alienation of their shares in a Soparfi only if the investor has not held the shares in the Soparfi for more than six months and has a participation representing more than 10 per cent of the share capital of the Soparfi. In all other cases, the capital gain is not taxable (unless the shareholding is held by the non-resident investor through a permanent establishment in Luxembourg). The same rule applies for liquidation surpluses distributed by Soparfis.

It is important to note that in most cases, if a double tax treaty concluded by Luxembourg is applicable, the non-resident investor could benefit from treaty protection (most of the double tax treaties concluded by Luxembourg stipulate that such capital gains are not taxable in Luxembourg, but in the country of residence of the foreign investor).

SIF

As a general rule, non-resident investors in a SIF or RAIF are not subject to Luxembourg income tax unless they invest in an FCP SIF or RAIF and receive capital gains taxable in Luxembourg (a rare scenario, as explained below).

SIF and RAIF – fiscally transparent

Generally, non-resident investors are not taxed in Luxembourg on the income (dividends, liquidation surplus and capital gains) deriving from a SIF incorporated under the form of an FCP, SCS or SCSp. However, if FCP SIF or RAIF hold a shareholding in a Soparfi, the non-resident investor would be deemed to hold directly the shares in the Soparfi owing to the tax transparency of the FCP SIF or RAIF. In this case, the non-resident investor could be taxed on the capital gain realised on the alienation of its units only if the investor has not held the shares in the Soparfi for more than six months and has a participation representing more than 10 per cent of the share capital of the Soparfi via the fiscally transparent FCP SIF or RAIF. It should be noted that such taxation could be mitigated if a double tax treaty concluded by Luxembourg (with the country of residence of the investor) was applicable and stipulated that such capital gain is not taxable in Luxembourg.

SIF and RAIF – fiscally opaque

Distributions made by a fiscally opaque SIF (including dividends and liquidation surpluses) are not subject to taxation in Luxembourg in the hands of a non-resident investor.

Non-resident investors are not taxed in Luxembourg for the capital gains realised upon the alienation of their shares in a fiscally opaque SIF.

SICAR and RAIF SICAR

Dividends and liquidation surpluses distributed by any type of SICAR or by a RAIF SICAR are not subject to Luxembourg taxation in the hands of non-resident investors (either fiscally opaque or transparent). The same rule applies for capital gains deriving from the sale of shares in the SICAR.

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19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is desirable and common practice in Luxembourg to obtain tax clearance from the tax authorities in order to get five years of certainty regarding the tax treatment of a private equity fund vehicle. The tax authorities may, under certain circumstances, confirm the application of certain statutory provisions to a particular structuring, although there is no general rule or requirement in this respect. It should be noted that the tax authorities will charge €3,000 to €10,000 for rulings. For ruling requests that meet the requirements (basically, the current requirements for a detailed description of facts and sufficiently detailed tax analysis), the responsible tax office will have to provide an answer. As of 1 January 2017, certain pieces of information on cross-border tax rulings and advanced pricing agreements are subject to automatic and spontaneous exchange of information obligations with jurisdictions 'affected' by the cross-border tax ruling or advanced pricing agreement.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

RAIFs, SICARs, SIFs and Soparfis are subject to an annual fee due to the Chamber of Commerce. SICARs and SIFs, given that they are regulated vehicles and supervised by the CSSF, have to pay certain fees to the CSSF.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

The initiators, to the extent that they are not residing in Luxembourg, of a RAIF, SICAR, SIF or Soparfi will generally be able to structure their management fees and any carried interest or incentive fee payments in a fiscally neutral manner in Luxembourg.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Luxembourg is currently party to 81 tax treaties covering most industrialised nations, according to data provided by the Luxembourg tax authorities, with some 16 additional treaties (including new treaties with countries having an existing treaty with Luxembourg) under negotiation or pending entry into force. Soparfis and fiscally opaque SICARs, in principle, should be entitled to benefit from all the treaties currently in force. Insofar as SIFs are concerned, they might be able to do so for those countries for which the Luxembourg tax authorities state that investment companies with variable capital and investment companies with fixed capital can benefit from the respective tax treaty, which are the treaties with Andorra, Armenia, Austria, Azerbaijan, Bahrain, Barbados, Brunei, China, Croatia, the Czech Republic, Denmark, Estonia, Finland, Georgia, Germany, Guernsey, Hong Kong, Isle of Man, Indonesia, Ireland, Israel, Jersey, Kazakhstan, Laos, Liechtenstein, Macedonia, Malaysia, Malta, Moldova, Monaco, Morocco, Panama, Poland, Portugal, Qatar, Romania, San Marino, Saudi Arabia, Serbia, Seychelles, Singapore, Slovakia, Slovenia, Spain, Sri Lanka, Tajikistan, Taiwan, Thailand, Trinidad and Tobago, Tunisia, Turkey, United Arab Emirates, Uruguay, Uzbekistan and Vietnam. For Bulgaria, Greece, Italy and Korea, the applicability of the tax treaty is not clearly derived from its wording.

In June 2017, Luxembourg formally signed the OECD's Multilateral Instrument (MLI) developed as part of BEPS Action 15. The MLI will implement in the tax treaties (between its signatories) certain recommendations arising from the BEPS project, for example, the prevention of treaty abuse and anti-hybrid rules. Luxembourg has not excluded any of its bilateral tax treaties from the scope of the MLI, but made a series of reservations regarding specific provisions. The government has not yet submitted a legislative proposal to ratify the MLI with Parliament.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

To the extent that SICARs, SIFs or any kind of AIF (including RAIFs) typically rely on the services of specialist investment managers or advisers, a specific VAT exemption applies to fund management services in accordance with article 44.1.d) of the Luxembourg VAT Law implementing article 135.1.g) of the EU VAT Directive 2006/112. This exemption also covers some of the administrative services generally provided to funds. The case law of the Court of Justice of the European Union confirmed that fund investment advisory services can be covered by the exemption, even when delegated to a third party, and irrespective of whether the fund investment adviser has a power of decision for the investment fund.

Although the question has not been formally addressed by the Luxembourg VAT authorities – or any judicial body – it appears that fund management services supplied to RAIFs should benefit from the same exemption.

Still based on the EU case law, funds benefiting from the VAT exemption for fund management services qualify as VAT taxable persons. Although this does not per se trigger an obligation for the SICARs, SIFs, RAIFs or other AIFs to register for VAT, the latter may have to do so, should they receive VAT taxable services from suppliers located outside Luxembourg. This is often the case, as the investment funds generally have to reimburse different parties for specific expenses.

SICARs, SIFs, RAIFs and other AIFs are in principle not able to recover VAT incurred on their costs. However, thanks to the broad application of the VAT exemption of article 44.1.d) of the Luxembourg VAT Law, this VAT leakage is in practice limited to the VAT due on services such as custodian notary, auditor or lawyer services. Moreover, the Luxembourg VAT rate is the lowest in the EU (17 per cent as of 1 January 2015, compared with an average of 21 per cent in the EU (20 per cent in the UK and 23 per cent in Ireland)).

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Most private equity funds will be privately placed within or outside of Luxembourg. Assuming that any such offering falls outside the scope of application of the Prospectus Directive 2003/71/EC of 4 November 2003 (Prospectus Directive), as amended, and Regulation No. 809/2004 of 6 April 2004, as amended, as implemented into Luxembourg law by the law of 10 July 2005 on prospectuses for securities, as amended (Prospectus Law), the offering will not be subject to additional rules or regulations (other than those provided for under the SICAR or SIF regimes). In an AIFMD scenario, EU-based AIFMs benefit from a European passport to market EU AIFs throughout the EU to professional investors. Extension of the passport to non-EU based AIFMs is on the agenda but not yet available. Luxembourg AIFs that are regulated AIFs established as SIF or SICAR are automatically authorised for marketing to 'well-informed investors' (see question 25) in the territory of Luxembourg. With respect to Luxembourg non-regulated AIFs (such as Soparfis), the marketing in Luxembourg is limited to professional investors. In terms of marketing of non-Luxembourg AIFs in Luxembourg, those AIFs benefit from the passport to the extent that their manager is an authorised AIFM either in Luxembourg or in another EU jurisdiction.

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25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Luxembourg private equity investment vehicles, whether they are formed as regulated or non-regulated vehicles, generally obtain their funding from institutional, professional or sophisticated private investors. However, the SICAR, SIF and RAIF legislation restrict the offering of an interest in a SICAR, SIF or RAIF to three 'well-informed' investor groups who are deemed to be able to adequately assess the risks associated with an investment in this type of vehicle. These three groups are:

- institutional investors;
- professional investors; or
- any other investors who meet the following conditions:
  - the first option is that they confirm in writing that they adhere to the status of well-informed investor and that they invest a minimum of €125,000 into the 'fund'; or
  - alternatively, if they invest less than €125,000, they must confirm in writing that they adhere to the status of well-informed investor and they must ensure that they have obtained an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC, by a management company within the meaning of Directive 2001/107/EC, or, in respect of RAIFs, by an authorised AIFM, certifying their expertise, experience and knowledge in adequately appraising an investment in the SICAR, SIF or RAIF.

For SICARs, SIFs and RAIFs, these conditions apply neither to the general partners of limited partnerships and of partnerships limited by shares, nor to their managers or any other persons involved in their management.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Investors in SICARs, SIFs or RAIFs are not subject to any notification, monitoring or approval from the CSSF. The CSSF may, however, request certain shareholder information when verifying the fund's compliance with applicable rules and regulations to ensure that only qualifying investors are invested into the 'fund'. For SICARs, however, the CSSF requires that the identity of the controlling ultimate beneficial owner, if any, be disclosed to it. Any such communication is protected by professional secrecy rules. Any change in the management, administration or custody of assets will, each time, require prior approval from the CSSF. With respect to Luxembourg-based AIFMs, they are required to file to the CSSF any substantial change to the information provided to it when filing for the AIFM licence (which includes change in the composition of ownership at the AIFM level).

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

One needs to establish whether the offeror is offering the investment on a professional basis or not. If the offeror is performing the services of an investment company or of another regulated activity of the financial sector, it will need to hold the requisite licences either in Luxembourg or abroad.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Pursuant to the Banking Law, as well as the Luxembourg laws of 19 February 1973 (as amended) on the sale of drugs and against drug addiction, 12 November 2004 (as amended), 17 July 2008 and 27 October 2010 relating to the fight against money laundering and against terrorist financing, to CSSF Regulation No. 12-02 of 14 December 2012 and to the CSSF Circulars 10/495 of 9 December 2010 and 13/556 of 16 January 2013, obligations have been imposed on all professionals of the Luxembourg financial sector to prevent the use of investment companies for money-laundering purposes. The same obligations have been extended to SICARs and SIFs by the law of 13 July 2007 (as amended) on markets in financial instruments implementing the European Directive 2004/39/EC on Markets in Financial Instruments into Luxembourg law.

Within this context, a procedure for the identification of investors is being imposed on all investors. Investor due diligence measures shall include, but are not limited to, the following:

- identifying the investor on the basis of documents, data or information obtained from a reliable and independent source;
- identifying the beneficial owner;
- taking 'reasonable measures' to understand the ownership and control structure of the investor;
- obtaining information on the purpose and intended nature of the business relationship; and
- conducting ongoing monitoring of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the professional's knowledge of the investor, the business and risk profile, including, where necessary, the source of funds and ensuring that the documents, data or information held are kept up to date.

Professionals of the financial sector are responsible for verifying whether professionals situated in third countries are subject to equivalent anti-money laundering obligations in their own country.

On 20 May 2015 a new EU Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing was adopted (Directive 2015/849). The Directive has to be implemented before 26 June 2017. Under the new Directive a wider scope of activities will require the performance of the customer due diligence.

In order to comply with the recommendations of the Financial Action Task Force and the 4th Anti-Money Laundering Directive, Luxembourg has introduced tax swindle as well as aggravated tax fraud as a primary offence for acts committed as of 1 January 2017. As of 2017, a distinction has to be made between:

- simple tax fraud;
- aggravated tax fraud, qualified as such depending on the amount of annual tax evaded; and
- tax swindle, defined as fraud involving a significant amount of taxes, which has been committed by the systematic use of fraudulent practices intended to conceal pertinent facts from the Luxembourg tax authorities.

While simple tax fraud is subject only to administrative sanctions, both the aggravated tax fraud and tax swindle constitute criminal offences for acts committed as of 1 January 2017.

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Update and trends

In 2017, Luxembourg strengthened its ranking as the world's second-largest fund domicile after the US, as the assets under management of Luxembourg-domiciled funds for the first time crossed the bar of €4 trillion and stood at €4.135 trillion as at 31 October 2017. This increase is not only based on the growth of traditional Luxembourg-domiciled UCITS funds, but also the result of the continued strong growth in respect of alternative investment funds, in particular in the areas of private equity and real estate.

The modernisation of the Luxembourg partnership regime (which was implemented together with the transposition of the AIFMD) has led to offering private equity houses and other fund initiators accustomed to Anglo-Saxon partnerships a new onshore alternative of fund structuring, regulated or not regulated as a product, linked to an EU-based AIFM, to access the AIFMD distribution passport to EU investors. This has been a significant driver for the success of Luxembourg as a European hub for the structuring of AIFs. There is no reason to doubt that this trend, which has been sustained by the increasing success of the new RAIF regime, will continue.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

The Luxembourg Stock Exchange (LuxSE) operates via the two following markets where the widest range of securities can be admitted to trading: an EU-regulated market within the meaning of the Markets in Financial Instruments Directive and published as such on the list of regulated markets on the website of the European Securities and Markets Authority (Regulated Market); and an exchange-regulated market, designated as the 'Euro multilateral trading facility market' (MTF Market). The Regulated Market offers a European passport for the admission to trading in more than one EU member state.

Issuers of securities on the Regulated Market are subject to the obligations of various European directives that have been implemented under Luxembourg law, in particular the Prospectus Directive and the Directive 2004/109/EC of the European Parliament and of the Council dated 15 December 2005 on the harmonisation of transparency requirements, as amended (Transparency Directive), implemented by the Luxembourg law of 11 January 2008, as amended (Transparency Law).

The CSSF is, as a rule, in charge of approving prospectuses for admission to trading on the Regulated Market.

The Euro MTF Market was launched in July 2005 following the adoption of the Prospectus Law in order to offer an alternative market to issuers that do not need to comply with EU regulations, in particular when they are not interested in 'passporting' their securities to other EU-regulated markets.

Prospectuses for an admission to trading on the Euro MTF Market must be drawn up in accordance with the internal rules and regulations of the LuxSE. Issuers may also choose to draw up their prospectus in accordance with Commission Regulation (EC) No. 809/2004 of 29 April 2004, as amended, implementing the Prospectus Directive.

The initial requirements for listing on both markets are similar. The application for a listing and admission to trading on the Regulated Market or on the Euro MTF Market will consist of the following:

- an application form for prospectus approval;
- a prospectus approved by the CSSF in respect of the Regulated Market or the LuxSE in respect of the Euro MTF Market;
- a letter of undertaking on future compliance with ongoing obligations;
- a declaration confirming, among other things, the compliance of the issuers' and securities' legal position and structure with applicable laws and the appointment of a financial institution so as to ensure the financial service of securities for securities holders in Luxembourg;
- the articles of association of the issuer; and
- the annual reports of the issuer for the past three years (or the initial balance sheet for a new issuer, for the period from incorporation until the date of the prospectus).

The ongoing and periodic disclosure requirements applicable to issuers of securities depend on the market where the securities are admitted to trading.

For issuers whose securities are admitted to trading on the Regulated Market, these obligations mainly arise from the Transparency Law and Part 1, Chapter 9 of the rules and regulation of the LuxSE (Rules and Regulations), Regulation (EU) No 596/2014 on market abuse (MAR) and the Luxembourg law of 19 May 2006 on takeover bids, as amended.

Issuers whose securities are admitted to trading on the Euro MTF Market do not fall within the scope of the Transparency Law. However, the new market abuse regime as set out in MAR now also applies to issuers with securities admitted to trading on the Euro MTF. As such, issuers with securities admitted to trading on the Euro MTF market need to comply with the ongoing and periodic obligations detailed in Part 1, Chapters 9 and 10 of the Rules and Regulations and MAR. Such ongoing and periodic disclosure obligations include, for instance, the provision of annual reports and interim financial statements and the disclosure of all other important information affecting the securities or the issuer. More stringent ongoing obligations apply to companies admitted to trading on the Regulated Market only.

A listing may facilitate fundraising by reaching a larger number of investors and furthermore increase the liquidity of otherwise rather illiquid investments. Certain institutional investors, furthermore, may only invest through listed private equity investment vehicles.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Listed private equity vehicles should, in principle, not be subject to any transfer restrictions. This requirement needs to be reconciled with the fact that investments in SICARs, SIFs and RAIFs are restricted to 'well-informed' investors only. The transfer restrictions are thus a crucial issue. In practice, the fund regulations will therefore provide for a forced repurchase or exit of non-qualifying investors.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

A Soparfi is not subject to any investment restrictions and thus may participate in a private equity transaction of any type or size. A SICAR or a RAIF SICAR may solely invest in risk-bearing (private equity) securities, being the direct or indirect contribution of assets to entities in view of their launch, development or listing in the stock exchange. This potentially qualifies any type of investment, whether in the form of equity or debt.

As far as the SICAR regime is concerned, the parliamentary documents give a further indication of the legislator's intent to provide maximum flexibility owing to the hybrid nature of true risk-capital financing. Listed companies therefore may also qualify as risk-bearing investments to the extent that the investment aims at the financing of, for example, a new business development or where the target company is to be taken private again. Most importantly, however, the SICAR is not subject to any risk-diversification rules and may thus concentrate its resources on a single target. The law, furthermore, does not impose any geographical or sector restrictions. A SICAR may be set up either as a single or as a multi-compartment (umbrella) entity, with each compartment of such a vehicle being linked to a specific portfolio of assets and liabilities that is segregated from the portfolio of assets and liabilities of the other compartments. Although the umbrella SICAR constitutes one single legal entity, the assets of a compartment are exclusively available to satisfy the rights of investors in relation to that compartment

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and the rights of creditors whose claims have arisen in connection with the operation of that compartment, unless a clause provided in the constitutive documents of the SICAR provides otherwise.

As far as the SIF and the RAIF are concerned, although the principle of spreading risk still applies, there are no preset quantitative, qualitative or other investment restrictions other than the 30 per cent safe harbour rule mentioned in question 1 (and which applies on a compartment-by-compartment basis for a SIF or a RAIF set up as an umbrella vehicle). The SIF and RAIF initiators may thus freely determine their investment policies (for example, within a single or multi-compartment (umbrella) SIF), investment restrictions or limitations. SIFs and RAIFs, furthermore, are not bound by any borrowing restrictions.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

While the SICAR Law, the SIF Law, the RAIF Law, as well as the CSSF do not impose specific restrictions on the structuring of the carried interest or the management compensation package, general rules and regulations will apply as to the structuring thereof and the remuneration rules contained under the AIFM Law may become applicable (both for SICARs, SIFs and RAIFs and non-regulated commercial companies within the scope of the AIFM Law). Different classes of securities can be created within a SICAR, a SIF or a RAIF, such classes potentially having different characteristics, notably as regards the fee structure, the type of targeted investors or the distribution policy. As far as the SICAR and SIF regimes are concerned, the CSSF will merely ensure that any such scheme is properly disclosed, giving investors the possibility to understand the full bearing thereof and, further, that it does not prejudice their interests. Should the AIFMD remuneration requirements be applicable, those requirements will be applicable at the AIFM level and require the latter to establish remuneration policies and practices that promote sound and effective risk management for those categories of staff whose professional activities have a material impact on the risk profiles of AIFs they manage. These categories of staff should at least include senior management, risk takers, control functions and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers. The AIFM shall set up remuneration policies and practices in accordance with the principles listed in Annex II to the AIFMD setting forth, inter alia, the following:

- that guaranteed variable remuneration should be exceptional and only occur in the context of hiring new staff and must be limited to the first year;
- that subject to the legal structure of the AIF, a substantial portion of any variable remuneration consists of units or shares of the AIF concerned; and
- that a substantial portion of the variable remuneration component is deferred over a period that is appropriate in view of the life cycle and redemption policy of the AIF concerned and is correctly aligned with the nature of the risks of the AIF in question.

It should be pointed out that compliance with these principles may take into account the appropriateness of the principles considering the size, internal organisation and the nature, scope and complexity of the relevant AIFM. Guidelines have been issued by the European Securities Market Authority in relation to the remuneration principles contained under Annex II of the AIFMD. These guidelines notably address how to apply the proportionality principle and remain to be incorporated by the CSSF in its supervisory practice.

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Saudi Arabia

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The establishment of and offer of units in private equity funds in Saudi Arabia is regulated by the Saudi Arabian Capital Market Authority (CMA) through the Investment Fund Regulations (IFRs).

Although the IFRs recognise funds as having a separate legal personality (with the ability to buy and sell assets), funds are not incorporated legal entities and do not have a commercial registration certificate. Rather, funds are established as a contractual arrangement entered into between a fund manager who is an authorised person licensed by the CMA to conduct managing activities (the fund manager) and the holders of the units in the fund (the unitholders). These terms and conditions set out the rights and obligations of the fund manager and unitholders.

Given that funds are not separate legal entities, all actions of the fund must be carried out by a fund manager and all assets must be held a separate entity, usually a custodian or a special purpose vehicle established by a custodian.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

In Saudi Arabia private equity funds are established by way of private placement process under the supervision of the CMA and in accordance with the requirements of the IFRs.

Prior to approaching the CMA, the fund manager must appoint an independent custodian to hold the fund's assets and an independent auditor.

The fund manager must then submit the following documents as part of the private placement offer:

- a declaration by the fund manager that the information contained in the notification to the CMA and the offering documents are clear, fair and not misleading (the form of which is specified in the IFRs);
- the fund's terms and conditions and any other offering documents;
- the fund manager's organisational structure;
- the fund's compliance monitoring programme; and
- a summary of the key terms of the terms and conditions.

The IFRs stipulate that the CMA has 15 business days to review the fund's application and offering documents. Should the CMA have no comments on the application or the offering documents, the fund manager may proceed with the offer to investors. However, in the event the CMA has comments, the 15 business-day review period will reset from the date the fund manager resubmits the application.

Private equity funds are not subject to any minimum capital requirement; however, each investor must subscribe for at least 1 million Saudi riyals for the offering to qualify as a private placement unless the investor is considered to be a 'sophisticated investor'.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

Private equity funds must at all times maintain a local custodian licensed by the CMA, although there is no requirement to appoint an administrator. However, any third-party administrator appointed by a fund must be licensed by the CMA to conduct custody activities.

The fund manager is required to host the registered office of the fund and carry out secretarial functions (ie, establish and maintain a register of unitholders). The fund manager must retain all books and records for a period of 10 years (or longer in the event of any ongoing or pending litigation, claim or investigations).

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The CMA's website contains a register of all public and private funds, which can be accessed at https://cma.org.sa/en/Market/imf/Pages/Private_Investment_Funds.aspx.

This register includes the following information:

- the fund's name;
- the date which the fund manager notified the CMA of its intention to establish the fund;
- the offer period dates; and
- the fund term.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Pursuant to article 77 of the IFRs, the unitholder's liability is limited to the amount of its investment in the fund and it will not be liable for the debts and obligations of the fund, although we are not aware of the extent to which this has been tested in Saudi courts.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Under the IFRs a fund manager is subject to a general duty to act in good faith for the benefit of the unitholders and to exercise reasonable care and skill in the discharge of its duties.

The Authorised Persons Regulations (APRs) separately provide that all authorised persons are subject to a number of prescribed

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fiduciary duties. Given that each fund manager is also an authorised person, fund managers are also subject to these duties, which are as follows:

- loyalty: a fund manager must act in all cases in good faith and in the interests of the unitholders;
- conflict of interest: a fund manager must ensure that no conflict of interest between its interests and the interests of the unitholders will affect the services the fund manager is providing;
- no secret profits: a fund manager must not use the unitholder's property, information or opportunities for its own or anyone else's benefit unless the fund manager makes full disclosure of such usage to the unitholder and obtains its consent; and
- care, skill and diligence: a fund manager owes the unitholders a duty to exercise the care, skill and diligence which would be exercised in the same circumstance by a person having both the knowledge and experience that may reasonably be expected of a person in the same position as the fund manager and the actual knowledge and experience that the fund manager has.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The definition of gross negligence is usually specified in the terms and conditions as the relevant CMA regulations to not provide a definition of gross negligence.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There is no guidance in the IFRs with regards to the redomiciliation of funds from foreign jurisdictions and no concept of converting any different form of vehicle to a fund in Saudi Arabia.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

There is no clear guidance as to the consequences or legal issues in the case of a fund manager's bankruptcy, insolvency, change of control or restructuring. However, article 20 of the IFRs invests the CMA with the authority to remove a fund manager in the event that such fund manager has materially failed to comply with the CMA's laws and regulations (including the minimum capital requirements set out in the APRs), the death, incapacity or resignation of a portfolio manager appointed to manage assets of the fund or any other grounds the CMA considers reasonable.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The CMA is the regulatory authority that oversees the financial services and asset management industry in Saudi Arabia. In addition to conducting regular audits on fund managers, the CMA has the right to inspect the books and records of a fund at any time upon request.

The fund manager must provide unitholders with annual reports (including audited financial statements) and short-form annual reports upon request and without charge.

The fund manager must also annual reports available no later than 70 calendar days from the end of the year and provide a copy of the report to the CMA within five days after delivering it to unitholders.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

A fund manager must be licensed by the CMA, as must the custodian and any third-party advisers appointed to by the fund (eg, administrator). However, if the fund is investing outside of Saudi Arabia the fund may appoint custodians or advisers licensed in the appropriate jurisdictions.

Prior to establishing the fund, the fund manager must submit the terms and conditions and any other offering documents for the CMA's approval. The IFRs stipulate that the CMA has 15 business days to review the fund's application and offering documents. Should the CMA have no comments on the application or the offering documents, the fund manager may proceed with the offer to investors. However, in the event the CMA has comments, the 15 business-day review period will reset from the date the fund manager resubmits the application.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

There is no requirement for a fund manager or any of its officers, directors or control persons to register as an investment adviser in Saudi Arabia.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The fund manager must be licensed by the CMA as an authorised person to engage in management activities. Authorised persons are governed by the APRs. Pursuant to the recently amended APRs, the minimum capital of a fund manager conducting management activities is 20 million Saudi riyals.

The following employees of a fund manager must be registered with the CMA:

- chief executive officer or managing director;
- finance manager;
- directors or partners;
- senior officers or managers;
- compliance officer;
- money laundering reporting officer;
- client functions, including sales representatives, investment advisers; and
- portfolio managers and corporate finance professionals.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

All contributions in Saudi Arabia are subject to the Saudi Anti-Bribery Law. That being said, there are no specific disclosure requirements or restrictions regarding political contributions.

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15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no specific disclosure requirements or restrictions in Saudi Arabia in relation to placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. The fund manager and its employees are not required to register as lobbyists to market to public pension plans and other governmental entities.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

The Saudi Arabian Monetary Agency (SAMA) is the authority governing and regulating investments by banks in Saudi Arabia. SAMA requires banks to maintain specific liquidity ratios but does not restrict banks from investing or sponsoring private equity funds.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Tax in Saudi Arabia is regulated by the General Authority for Zakat and Tax (GAZT). Pursuant to Saudi Arabia's tax regulations, private equity funds are deemed as 'capital companies', which contemplates that they are subject to the following:

- 2.5 per cent zakat (tax on wealth) in the case that the fund is owned by Saudi Arabian nationals or Gulf Cooperation Council (GCC) nationals (ie, Bahrain, United Arab Emirates, Kuwait, Oman and Qatar);
- 20 per cent tax on profits in the case that the fund is owned by non-GCC unitholders; and
- 5 per cent withholding tax on payments of all dividends and capital gains to unitholders.

However, since 2006, the GAZT has not assessed any taxes on private equity funds in Saudi Arabia or its unitholders. This is not deemed a formal exemption and GAZT reserves the right to begin taxing funds at any point in the future (including on a retroactive basis).

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident unitholders in Saudi Arabian funds are not obliged to file tax returns or pay tax to the GAZT with respect to any units held in any private fund.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

There is no requirement to obtain tax rulings from the GAZT or any other local tax authority for the purpose of establishing a private equity fund.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

No organisational taxes are required to be paid with respect to private equity funds.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

A Saudi fund manager or entity receiving such payments is be required to report the management fees in its tax or zakat returns and pay income tax or zakat due from such returns.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Saudi Arabia has double tax treaties with several countries including Austria, Bangladesh, Belarus, China, the Czech Republic, France, Greece, Hungary, India, Italy, Japan, Korea, Luxembourg, Malaysia, Malta, the Netherlands, Pakistan, Poland, Romania, Russia, Singapore, South Africa, Spain, Syria, Tunisia, Turkey, Ukraine, the United Kingdom, Uzbekistan and Vietnam.

Given that Saudi Arabian funds are currently not assessed for taxes by the GAZT, the treaties have a limited impact. However, the treaties with some countries reduce payments of dividends and capital gains to zero per cent and therefore may be useful if the tax treatment of funds is altered in the future.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Unitholders and fund managers in Saudi Arabia must be aware that while funds are currently tax-free, the GAZT reserves the right to begin taxing funds at any point in the future (including on a retroactive basis).

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

An offer of units in a private fund is a private placement where the offerees are 'sophisticated investors' or the minimum amount payable per offeree is not less than 1 million Saudi riyals. All funds must be registered with the CMA and there are no exemptions to such registration.

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25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Private equity funds may be offered to 'sophisticated investors' or investors who subscribe for a minimum of 1 million Saudi riyals.

Sophisticated investors means any of the following:

- authorised persons acting for their own account;
- clients of a person authorised by the CMA to conduct managing activities provided that:
  - the offer is made through authorised person and all relevant communications are made through the authorised person; and
  - the authorised person has been appointed as an investment manager on terms that enable it to make decisions concerning the acceptance of the private offers of securities on the client's behalf without reference to the client;
- the government of Saudi Arabia, any supranational authority recognised by the CMA, the Saudi stock exchange and any other stock exchange recognised by the CMA or the Depositary Centre;
- institutions acting on their own account;
- professional investors (a definition of which is set out in the CMA's Glossary of Defined Terms); or
- registered persons with an authorised person if the offer is made through the respective authorised person itself.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The fund manager must establish and maintain a register of unitholders that includes each unitholder's name, ID, nationality, date of registration in the fund register, details of transactions conducted by such unitholder, the running balance of the number of units and any restrictions or rights attached to such units.

The fund manager must make the register of unitholders available to the CMA for inspection upon request.

Changes in ownership of the fund manager must be approved by the CMA and 30 days' advance notice must be given prior to any proposed change of control of the fund manager.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Private equity funds in Saudi Arabia may only be established, and units of such funds may only be offered by a fund manager (licensed by the CMA to conduct management activities), following the expiry of the 15 business-day non-objection period, following which the fund is registered with the CMA.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

A fund manager must comply with all obligations under the CMA's Anti-Money Laundering Law and Counter Terrorism Financing Rules.

A fund manager must appoint a senior employee as a money laundering reporting officer. The money laundering reporting officer is responsible for ensuring compliance with the requirements of the Anti-Money Laundering Law and its implementing regulations and reporting to the governing body on matters relating to money laundering and terrorism financing.

Furthermore, all unitholders must complete know-your-customer forms (acceptable to the CMA) and provide supporting documentation, and the fund manager must disclose to the CMA a list of all investors who subscribe to units in the fund.

Finally, the fund manager must take a risk-based approach to conduct due diligence on investors; however, lower due diligence requirements are set (ie, beneficial shareholding confirmation is not required) if the investor is:

- regulated and licensed by a government authority;
- based in a jurisdiction that complies with the Financial Action Task Force recommendations; and
- applies anti-money laundering and counter-terrorism requirements that are consistent with Saudi Arabia's regulations and the Financial Action Task Force recommendations.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds are not permitted to list on the Saudi stock exchange. Only exchange-traded funds and real estate investment-traded funds are permitted to be listed.

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30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Private equity funds are not permitted to list on the Saudi stock exchange. Only exchange-traded funds and real estate investment-traded funds are permitted to be listed.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

Although the IFRs refer to funds as having some of the attributes of a legal entity, such as buying and selling assets, it should be noted that funds are not incorporated entities and do not have a commercial registration certificate, but are a form of a contractual arrangement that does not make a fund a juristic person and therefore may not participate directly in private equity transactions. Pursuant to the APRs, the assets of a fund must be held by a custodian.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Only a person authorised by the CMA (licensed to conduct management activities) may be paid management fees. If the fund has multiple sponsors, all fees must be paid to the CMA-regulated sponsor by the fund, who can then pay these fees on to the other sponsors. There are no such restrictions on carried interest or other profit-sharing, which can be paid directly to non-regulated entities.

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Singapore

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In practice, leveraged buyout (LBO) funds formed in Singapore are rare. If the LBO fund is to be established in Singapore, it will take the form of a limited liability corporation that will have separate legal existence from the investors and the manager. The investors and the manager will not be responsible for the obligations of the LBO fund.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

A two-stage procedure comprising reservation of name and submission of application papers, it will take usually less than three business days to complete the incorporation process. The entire process is done electronically and the one-off fee (no recurring fee is payable) payable to the relevant government agency is S$300. There is no minimum capital requirement. Corporate service providers and law firms provide incorporation services.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

There is no requirement for the private equity fund vehicle to maintain a custodian or administrator. The only local requirement is to have a Singapore-resident company secretary (who must be a natural person) and registered office where the corporate secretarial books should be kept. The company secretary is typically a person from an external corporate service provider engaged to provide corporate secretarial services. However, the fund manager of the private equity fund vehicle is required to ensure that assets under management are subject to independent custody, and such independent custodians must be licensed, registered or authorised in their respective jurisdictions.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Identities of registered shareholders and their paid-up capital amount can be obtained from an online search made with the government agency. Such information is obtained from annual and other periodic returns that an LBO fund has to submit, and the failure to submit the same would render the LBO fund and responsible directors liable to fines. The LBO fund has to file annual audited accounts to the government agency, which are also publicly accessible.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The 'corporate veil' will be lifted only where there are abuses of the limited liability status of the corporation, such as where third-party investors induce others to give credit to the LBO fund where they know there is no reasonable expectation that the debt could be repaid.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The fund manager's fiduciary duties are not prescribed by law (unless the fund manager is a trustee of an investment trust; the latter is not a vehicle used for LBO funds) and could be modified by agreement in the fund management agreement between the fund and the manager.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Gross negligence as opposed to negligence simpliciter has been judicially recognised in litigation involving a contractual disclaimer clause. While not in the LBO context, the same principle should apply.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are no special issues or requirements particular to LBO funds formed in Singapore. The Limited Partnership Act came into force in May 2009, and it is possible to form limited partnerships in Singapore by registering with the Accounting and Corporate Regulatory Authority (ACRA). However, conversion or redomiciling of non-Singapore limited partnerships to Singapore limited partnerships is not statutorily recognised.

The inward redomiciliation regime, introduced in the Companies (Amendment) Act 2017, came into effect in Singapore on 11 October 2017. The inward redomiciliation regime will enable foreign corporations to transfer their registration to Singapore. This will facilitate

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the relocation by foreign corporations of their regional or worldwide headquarters to Singapore. Under the proposed regime, an inbound corporation that is redomiciled to Singapore will become a Singapore company and will be required to comply with the provisions of the Companies Act, like any other Singapore company.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The insolvency of the sponsor would not have a direct impact on the LBO fund and the fund manager or adviser as the latter are separate legal entities from the sponsor. However, it is common for the legal documentation to provide for consequences in the event of bankruptcy, change of control, restructuring and other analogous events affecting the sponsor, such as the right to remove the fund manager or adviser if they are affiliated entities. It is uncommon to contractually prescribe automatic dissolution of the LBO fund upon such events.

Other regulatory consequences if the sponsor becomes insolvent or undergoes a change of control might be the loss of the fund management licence by the fund manager if it is an affiliated entity of the sponsor, or if the fund manager is exempted from licensing (see question 10) the Monetary Authority of Singapore (MAS) may revoke the ability of the fund manager to operate on an 'exempt from licensing' basis. A mere change of control compared to insolvency is less likely to result in the loss of licensing or exemption from licensing, but the Singapore regulatory authorities would have regard to the circumstances resulting in the change of control.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

If the LBO fund is offered to the public for investment, a prospectus must be lodged with the MAS, which has the power to require all information it deems necessary before registering the prospectus. If the fund manager manages the LBO fund out of Singapore, it will need to be registered or licensed with the MAS for performing fund management activities. The MAS has untrammelled audit and inspection rights over registered and licensed fund managers in Singapore.

Pursuant to a regulatory change that took effect in August 2012, there are now three categories of fund management companies (FMCs) regulated by the MAS, namely, Registered FMCs, Licensed Accredited/Institutional FMCs and Licensed Retail FMCs. Registered FMCs are FMCs whose assets under management are not more than S$250 million and serve not more than 30 qualified investors (of which not more than 15 are funds), which include closed-end funds and collective investment schemes. The underlying investors of such funds must be accredited investors or institutional investors, or both. Exempt FMCs under the previous regime will be known as Registered FMCs. Licensed Accredited/Institutional FMCs are licensed FMCs who serve only accredited and institutional investors. Where the Licensed Accredited/Institutional FMCs manage funds such as collective investment schemes or closed-end funds, then the underlying investors of these funds must also be accredited investors or institutional investors. Licensed Accredited/Institutional FMCs will only be able to commence business following the grant of their licence in fund management. Licensed Retail FMCs are licensed FMCs who serve retail investors.

For Licensed Accredited/Institutional FMCs and Licensed Retail FMCs, its officers who perform the actual fund management duties need to have a representative licence. The MAS will evaluate the directors and substantial shareholders (entities who control or own at least 5 per cent of the share capital of the fund manager) in considering whether it will grant a licence. Following the award of the licence, any change of director or shareholder controlling 20 per cent of the share capital of the fund manager must receive prior approval from the MAS.

The requirements in the preceding paragraph do not apply to Registered FMCs. Registered FMCs are only required to notify the MAS of the identities of its directors and substantial shareholders at the time of registering themselves with the MAS and subsequently any change of the same. However, the MAS has the power to revoke a registration if it believes it is in the public interest to do so, and in such event the fund manager would either have to obtain a licence or cease its licensable activity in Singapore.

Registered FMCs and Licensed Accredited/Institutional FMCs are required to provide adequate disclosure to their investors on issues such as custodial and fund administration arrangements, compliance arrangements, potential conflicts of interests and professional indemnity insurance arrangements. For Retail FMCs, disclosure requirements are mandated in the prospectus of the fund offerings.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Pursuant to a regulatory change that took effect in July 2013, a closed-ended fund will be deemed and regulated as restricted collective investment schemes (CISs) if, among other things, the following is true:

- it falls within the definition of 'collective investment scheme' under section 2(1) of the Securities and Futures Act (SFA);
- all or most of its issued units cannot be redeemed at the election of the unitholders; and
- it operates in accordance with an investment policy under which investments are made for the purpose of giving participants the benefit of the results of the investments, and not for the purpose of operating a business.

Any offer of units in such closed-ended funds must comply with the requirement to submit a notification and annual declaration to the MAS, as well as furnish an information memorandum that complies with specific disclosure requirements.

The matters to be disclosed in an information memorandum issued in connection with an offer of units in such restricted CISs are as follows:

- the investment objectives and focus of the scheme;
- the investment approach of the manager for the scheme;
- the risks of subscribing for or purchasing units in the scheme;
- whether the offer of units in the restricted scheme is regulated by any financial supervisory authority and, if so, the title and jurisdiction of the legislation under which the restricted scheme is regulated and the name and contact details of the authority;
- whether the manager for the scheme and, where applicable, the trustee or custodian, are regulated by any financial supervisory authority and, if so, the name and contact details of the authority;
- the name and place of incorporation or registration of the manager for the scheme and, where applicable, the trustee or custodian for the scheme;
- in the case of a restricted foreign scheme that is a corporation, its place of incorporation and business address;
- where applicable, the policy of the scheme regarding side letters that may further qualify the relationship between the scheme and selected investors and the nature and scope of such side letters;
- where applicable, the past performance of the restricted scheme, or where information on the past performance of the scheme may be obtained;
- the details of where the accounts of the scheme may be obtained; and
- the fees and charges payable by the investors and by the scheme.

It is immaterial whether there are significant investment activities in Singapore.

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12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Acting as an investment adviser without discretionary investment authority is treated the same way as a fund manager with discretionary investment authority. Hence, other than as described in question 10, there is no other requirement for the fund manager to be licensed or registered as an investment adviser in Singapore.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

FMCs are also required to establish and operate out of a physical office in Singapore and its directors and officers must satisfy the 'fit and proper' criteria of the MAS.

In addition, for a Registered FMC and Licensed Accredited/Institutional FMC, the only requirements (other than as described in question 10) are they need to have a minimum of two full-time individuals (who can be directors or representatives, or both, of the FMC) residing in Singapore, each of whom having a minimum of five years of relevant experience and satisfying the 'fit and proper' criteria of the MAS, which essentially require the applicant to ensure these individuals have the integrity and competence to discharge the duties of a fund manager. The relevance of the individual's experience will be assessed in relation to the function that the individuals will be performing on behalf of the FMC. Registered FMCs must notify the MAS when it ceases operations in Singapore and file an annual return to the MAS to report on the number of 'qualified investors' it acts for and its assets under management (AUM).

For licensed FMCs, the minimum base capital for the applicant is S$1 million or S$500,000 if the applicant does not manage collective investment schemes. The MAS may require that the applicant takes out a professional indemnity insurance policy as a licensing condition. The licensed representatives and directors must also satisfy the 'fit and proper' criteria of the MAS.

Other than as described in question 10, the MAS would expect a Licensed Retail FMC to be the following:

- a reputable entity having at least a five-year track record;
- if it is a subsidiary of a foreign parent company, the latter to have a good reputation in its home country;
- subject to proper supervision by a recognised home regulatory authority;
- to have group AUM of at least S$1 billion if it wants to be a Licensed Retail FMC; and
- to have a chief operating officer with a minimum of 10 years' experience in the financial services industry.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

Not applicable.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Not applicable.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

On 5 July 2010, the MAS issued its response to feedback received on its 16 December 2009 consultation paper entitled 'Consultation paper on proposed requirements for bank's private equity and venture capital investments' (the Consultation Paper). The banking regulations (the Regulations) have been amended with effect from 5 July 2010 and a revised version of MAS Notice 630 – Private Equity and Venture Capital Investments (the Notice) has been issued to implement the proposals in the Consultation Paper.

Under section 32 of the Banking Act (the Act), banks are prohibited from acquiring or holding major stakes in any company without the MAS' approval. Regulation 7 of the Regulations excludes private equity and venture capital (PE/VC) investments from the ambit of section 32. The Consultation Paper had proposed changes in three main areas to provide banks with greater scope and flexibility in their PE/VC investments: scope of PE/VC investments; duration of investments; and bank's involvement in management.

Scope of PE/VC investments

The characterisation of PE/VC investments in the Regulations and Notice has been expanded to include a wider range of investments. Under the revised scope, PE/VC investments would include investments where significant stakes are taken in companies with potential for high growth or value creation. However, an investment in a company carrying on a financial business that has such potential would not qualify as a PE/VC investment. The MAS has also clarified that the PE/VC exclusion under the Regulations is not intended to apply to investments in property-related activities.

Duration of investments

The duration of investments has been reduced to a seven-year limit (previously 10 years) for direct PE/VC investments or investments in funds managed by the banks, and a 12-year limit (previously 15 years) for PE/VC investments in independent funds. Banks may hold a PE/VC investment in a fund that is managed by the bank or a party related to the bank for 12 years if the bank's investment in the fund is less than 50 per cent of the total fund size within five years from the date of the inception of the fund, or if the duration of investment for each underlying PE/VC investment in the fund is less than seven years. The MAS will permit existing PE/VC investments to be held for the duration that was previously allowed under the Notice.

Management involvement

Bank executives under the bank's private equity business line would be allowed to be involved in matters that are typically discussed at board level or strategic issues. This should not pertain to the day-to-day operational matters of the PE/VC investees, or where involvement may give rise to conflicts of interest in the investee's transactions with the bank.

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Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

The LBO fund would be subject to corporate income tax on its income just like any Singapore incorporated company. There is no capital gains tax in Singapore. There is no withholding tax on dividend distributions by the LBO fund to non-resident investors. If any interest or royalty is paid by an LBO to non-resident investors, withholding tax at the rate of 15 per cent is applicable.

The LBO fund may apply to the MAS to be approved as a Singapore tax-resident fund to enjoy certain tax incentives under section 13R of the Singapore Income Tax Act (the Scheme). Under the Scheme, as long as the conditions set out below are met, the fund will be exempted from most forms of Singapore income tax, including the gains or profits realised from the acquisition and divestment of portfolio investments that might otherwise be taxable as trading income. Note that the Scheme will not exempt the fund from income tax arising from the holding of Singapore immovable properties or Singapore-sourced interest.

The conditions under the Scheme are as follows:

- the fund must be a Singapore incorporated company and Singapore tax resident;
- the fund must not be 100 per cent beneficially owned by Singapore resident persons;
- the fund must be managed or advised directly by a Singapore fund management company and use a Singapore-based fund administrator if the administration is outsourced by the fund manager;
- the fund must incur at least S$200,000 in local business spending each year. The expenses can include the fund management fees; and
- the fund must not change its investment objective or strategy after being approved for this tax incentive scheme.

Another consideration arising from the Scheme is that 'qualifying investors' of the fund will be effectively exempted from all Singapore tax on distributions made by the fund to them. However, there will be a punitive effect on 'non-qualifying investors' who shall be required to pay a financial amount to the Inland Revenue Authority of Singapore based on its share of the fund's income (as reflected in the fund's audited accounts) multiplied by the corporate income tax rate (currently 17 per cent). The following persons will be regarded as 'qualifying investors':

- any natural person investing in the fund;
- any bona fide non-Singapore tax resident investor that:
  - does not have a permanent establishment in Singapore (other than a fund manager); or
  - has a permanent establishment in Singapore but does not use funds from its Singapore operations to invest in the fund;
- any person so designated by the MAS; and
- any person not covered above and who does not (on its own and with his or her affiliates) own more than 30 per cent of the fund's equity if the fund has fewer than 10 investors, or 50 per cent of the fund's equity if the fund has 10 or more investors.

Any person who is not a 'qualifying investor' shall be a 'non-qualifying investor'.

The LBO fund may also apply to the MAS to be approved as a Singapore tax-resident fund to enjoy certain tax incentives under section 13X of the Singapore Income Tax Act (the Enhanced-Tier Scheme). Under the Enhanced-Tier Scheme, as long as the conditions set out below are met, the fund will be exempted from most forms of Singapore income tax, including the gains or profits realised from the acquisition and divestment of portfolio investments that might otherwise be taxable as trading income. Please note that the scheme will not exempt the fund from income tax arising from the holding of Singapore immovable properties or Singapore-sourced interest.

The conditions under the Enhanced-Tier Scheme are as follows:

- the fund must be a Singapore incorporated company, trust or limited partnership and Singapore tax resident;
- the fund must have a minimum fund size of S$50 million in committed capital;
- the fund must be managed or advised directly by a Singapore fund management company and use a Singapore-based fund administrator if the administration is outsourced by the fund manager;
- the fund management company must employ at least three investment professionals;
- the fund must incur at least S$200,000 in local business spending each year. The expenses can include the fund management fees;
- the fund must not change its investment objective or strategy after being approved for this tax incentive scheme; and
- the fund must not concurrently enjoy other tax incentives.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

No, except to the extent the LBO fund qualifies under the Scheme, a non-resident investor who is or becomes a 'non-qualifying investor' as described in question 17 would have to pay the punitive financial amount as described in question 17.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

None is required unless the LBO fund wishes to qualify under the Scheme, in which event an application to the MAS (and not the Singapore tax authorities) is required. There are no special rules relating to investors that are Singapore residents other than in connection with the Scheme as described in question 17.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

No.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

The management fees and carried interest payable to the fund manager would be taxable in Singapore as fee income if the fund manager is tax-resident in Singapore. There is a tax incentive scheme known as the Financial Sector Incentive Scheme – Fund Management (FSI-FM), which a fund manager may apply for, and if awarded at the discretion of the MAS, a concessionary tax rate of 10 per cent under the FSI-FM scheme will apply to the fee income. The standard corporate income tax rate is currently 17 per cent. Under the Scheme, if any investor of the LBO fund is not a 'qualifying investor' as described in the response to question 17, the fund manager (if it is awarded the FSI-FM tax incentive) will lose the concessionary tax rate of 10 per cent for the full year of assessment relating to the financial year in which the fund has a non-qualifying investor.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The LBO fund would be able to access any of the tax treaties entered by Singapore (currently 82 comprehensive avoidance of double taxation agreements, which generally cover all types of income) since the LBO will be resident in Singapore.

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Update and trends

Following the amendments to the Companies Act, Singapore companies and limited liability partnerships, as well as foreign companies registered to do business in Singapore, are required to keep registers of significant controllers and nominee directors at prescribed places (eg, the company's registered office or the registered office of the registered filing agent). The registers will not be open to inspection by the public but must be available for inspection by the Accounting and Corporate Regulatory Authority (ACRA) and law enforcement agencies. The aim of the requirement for the maintenance of registers of significant controllers is to make the ownership and control of corporate entities more transparent and reduce opportunities for the misuse of corporate entities for illicit purposes.

A controller is defined as an individual or a legal entity that has a 'significant interest' in or 'significant control' over the company. A controller who has significant control over a company is a person who:

- holds the right to appoint or remove directors who hold a majority of the voting rights at directors' meetings;
- holds more than 25 per cent of the rights to vote on matters that are to be decided upon by a vote of the members of the company; or
- exercises or has the right to exercise significant influence or control over the company.

An individual or legal entity has significant interest in a company having a share capital if:

- the individual or legal entity, as the case may be, has an interest in more than 25 per cent of the shares in the company or foreign company; or
- the individual or legal entity, as the case may be, has an interest in one or more voting shares in the company; and the total votes attached to that share, or those shares, is more than 25 per cent of the total voting power in the company or foreign company.

An LBO fund that is structured as a Singapore company will be required to:

- take reasonable steps to identify its registrable controllers and obtain information on its registrable controllers, by sending out notices to anyone whom it knows or has reasonable grounds to believe to be registrable controllers; or who knows the identity of the registrable controllers or is likely to have that knowledge;
- ensure that the registers of controllers are up to date by updating the registers within two days of receiving information on the controllers; and
- declare in its annual return filed with ACRA that its registers of controllers are kept up to date.

In addition, if the LBO fund that is structured as a Singapore company knows or has reasonable grounds to believe that a relevant change has occurred in the particulars of a registrable controller, it must give notice to the registrable controller to confirm if there has been a change and find out details of the change.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

No.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

An offer of interest in an LBO fund that is made in Singapore would prima facie require an accompanying prospectus lodged with, and registered by, the MAS unless the offer falls within one of a few 'safe harbours' in the SFA. There are prescribed disclosure requirements for the prospectus in the SFA.

For an LBO fund, the available 'safe harbours' are as follows:

- where the offers are made only to institutional investors as prescribed in the SFA, for example, insurance companies and pension fund managers; and
- the 'private placement exemption', which is available if the offer is made to no more than 50 entities in any 12-month period, subject to aggregation rules.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

If a prospectus is lodged with, and registered by, the MAS, there is no restriction on the types of investor that may participate in the LBO fund. If a 'safe harbour' is relied upon, depending on the category relied upon (as described in question 24), the investors that may participate have to be restricted accordingly. There is no restriction on the types of investor if the safe harbour is the private placement exemption as described in question 24.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

None, except where the LBO fund is listed on an approved securities exchange in Singapore (namely, the Singapore Exchange Securities Trading Limited, which is the only approved equities securities exchange), any person who becomes a substantial shareholder of the LBO fund (entities who control or own at least 5 per cent of the share capital of the fund) has to notify the LBO fund and the Singapore Exchange Securities Trading Limited within two business days. Any change of interest held by a substantial shareholder that exceeds the threshold of 1 per cent must be reported to the LBO fund and the Singapore Exchange Securities Trading Limited within the same time frame. See question 10 in relation to notification requirements for change in control of the fund manager.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

If the person offering the interest is the LBO fund itself offering shares for subscription, no licence or registration (other than registration of a prospectus where required as described in question 24) is necessary. A broker-dealer or other financial intermediary marketing the interest in the LBO fund will require a licence from the MAS for dealing in securities.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

There are general laws in Singapore applicable to everyone that prohibit money laundering. These laws do not prescribe any rule on how due diligence, record keeping or reporting of suspicious transactions should be carried out. Whistle-blowing on suspected money laundering transactions is mandatory, with only qualified Singapore

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advocates and solicitors excused by legal communication privilege for not whistle-blowing.

Financial institutions involved in granting credit, marketing securities (such as interest in an LBO fund) or management of funds are subject to guidelines from the MAS on anti-money laundering. Essentially, these financial institutions must establish internal 'know your client' procedures to establish the bona fides of their clients, perform enhanced due diligence if the client is a 'politically exposed person' and maintain documentary records relating to their clients' identities and transactions undertaken for a minimum period of five years. The MAS is the designated suspicious transaction reporting office for financial institutions to whistle-blow on suspected money-laundering transactions.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

LBO funds may list as an investment fund on the Singapore Exchange Securities Trading Limited (which is the only approved equities securities exchange in Singapore) but none has been listed to date. For an LBO fund denominated in Singapore dollars, the main listing criteria are a minimum asset size of at least S$20 million and at least 25 per cent of the fund's share capital must be held by at least 500 public investors. For an LBO fund not denominated in Singapore dollars, the main listing criteria are a minimum asset size of at least US$20 million (or equivalent in foreign currency) and a spread of holders necessary for an orderly market in the shares. The continuous listing requirements are largely the same as any listed issuer on the Singapore Exchange Securities Trading Limited with the notable exception that a weekly reporting of the LBO fund's net tangible asset value to the Singapore Exchange Securities Trading Limited is required. Listing will allow investors of the LBO fund to exit their investment if the LBO fund does not offer redemption of shares. The disadvantage of listing is that closed-ended investment funds listed on the Singapore Exchange Securities Trading Limited have traditionally traded at a significant discount to their net tangible asset values and there is little investor awareness and trading volume on such listed stocks.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As trading of listed stock is carried out through an electronic trading system operated by the Singapore Exchange Securities Trading Limited, for listed shares it is not feasible for the fund manager to impose restrictions on transfers of interests to certain parties. If shares of promoters of the fund are to be placed under a transfer moratorium, the practice is to require these shares not to be deposited with the central depository (or deposited but endorsed as 'under moratorium'), which is a prerequisite for the trading of shares on the Singapore Exchange Securities Trading Limited.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

No, unless such funds are authorised or recognised collective investment schemes (a prerequisite to offer such funds for sale to the public), which must comply with prescribed investment restrictions. These investment restrictions generally require authorised and recognised collective investment schemes to invest only in listed equities securities or debt securities that are rated investment grade.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There is no legal or regulatory issue that will affect compensation of the fund manager.

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Spain

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Alter Legal

Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The Spanish Law on Venture Capital Entities (Law No. 22/2014 of 12 November 2014) contemplates three main different types of venture capital entities: private equity funds (FCRs), private equity companies (SCRs) and venture capital entities for small and medium-sized investments (ECRs-Pyme). The Law refers to FCRs, SCRs and ECRs-Pyme as venture capital entities (ECRs).

FCRs, SCRs and ECRs-Pyme must be registered with the Spanish Securities Exchange Commission (CNMV). ECRs are regulated and supervised by the CNMV.

Venture capital entities can be managed by management companies of closed-ended collective investment entities (SGEICs) or by management companies of collective investment schemes (SGIICs). Both management entities require authorisation by the CNMV and are subject to supervision and regulation by the CNMV.

FCRs

An FCR is a pool of assets divided into units, without legal personality. An FCR must comply with the provisions contained in Law No. 22/2014 and with its own regulations as established in its incorporation documents.

Owing to its lack of legal personality, an FCR must be managed by an SGEIC or by an SGIIC.

SCRs

SCRs are corporate entities that are subject to the provisions of Law No. 22/2014 and are therefore subject to a particular regulatory and tax regime. They are also subject to the provisions of the Spanish Corporate Law. An SCR may either be self-managed (through its board of directors), or managed by an SGEIC or an SGIIC. Self-managed SCRs require authorisation by the CNMV prior to their incorporation.

Investors in the FCR and shareholders in the SCR are liable respectively for the FCR's and SCR's liabilities, up to the amount contributed through the subscription of units (FCR) or shares (SCR).

Investors who wish to have a direct involvement in the management of their portfolio usually prefer to invest in SCRs. In addition, those investors looking for Spanish tax incentive schemes on reinvestments may prefer to invest in an SCR (as FCRs would not qualify for such tax incentives and SCRs, if certain requirements are met, may qualify for such purposes).

On the other hand, FCRs are not subject to legal requirements generally applicable to corporations that give shareholders substantial rights to participate in, or to control, the board of directors (as is the case in SCRs). The role of investors in FCRs is generally passive, which makes FCRs more appropriate for investment funds managed independently.

ECRs-Pyme

ECRs-Pyme are considered a special type of ECR, which may adopt the form of FCR or SCR.

ECRs-Pyme must comply with the investment restrictions established in section 3a of Law No. 22/2014. Particularly, they must invest at least 75 per cent of their assets in equity or equity-related instruments in small and medium-sized entities that meet with the following requirements:

- are not listed;
- have less than 250 employees;
- have annual assets not exceeding €43 million or turnover not exceeding €50 million;
- are not a financial or a real estate company;
- are not a collective investment scheme; and
- are established in an EU country or third party that is not designated as a 'non-cooperative country or territory' by the Financial Action Task Force on Money Laundering, or which has subscribed with Spain an agreement to avoid double taxation with an information exchange clause or an agreement to exchange tax information.

ECRs may have different classes of units or shares, which may help to set up a more tax-efficient carried interest structure for founders and promoters.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

ECRs shall be formed in Spain by virtue of a public deed of incorporation granted by a public notary, and their incorporation should be registered with the Mercantile Registry. However, those requirements are not compulsory if the ECR takes the form of an FCR (in such a case, the FCR may be formed by virtue of a private agreement of incorporation that is not filed with the Mercantile Registry).

Once the ECR has been duly incorporated, all relevant documentation and information shall be filed with the CNMV. The CNMV will proceed to the registration of the ECR with the relevant CNMV Registry once the CNMV has reviewed all relevant documentation and has considered such documentation complete. Notwithstanding the above, a self-managed SCR must be authorised by the CNMV prior to its incorporation.

If the promoters wish to promote an FCR, or an SCR managed by an SGEIC, the latter (the management company) would need to be incorporated and registered with the CNMV prior to filing the documentation related to the ECR. The SGEIC, once it has obtained the required approval by the CNMV, will have to be registered with the Mercantile Registry and with the CNMV. SGEICs and SCRs will also have to draft and file with the Bank of Spain their anti-money laundering procedures.

Pursuant to article 46 of Law No. 22/2014, the approval process of an SGEIC or a self-managed SCR should generally take three months from the date of the application for authorisation to the CNMV or the date in which all documentation requested by the CNMV has been submitted.

An FCR's main required documentation shall include its agreement of constitution (which may be formalised by virtue of a public

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deed, or in a private document) the management regulations and its prospectus. The agreement of constitution shall include the name of the FCR, its purpose (as established in articles 9 and 10 of Law No. 22/2014), the amount of subscribed capital and the name and domicile of its management company. FCRs must have a minimum subscribed capital of €1.65 million of which, according to CNMV interpretation of Law No. 22/2014, at least €165,000 should be paid up on the date of constitution.

An SCR's required documentation shall include the prospectus, its public deed of incorporation and company by-laws. The company by-laws shall include the SCR investment policy (as established in article 12 of Law No. 22/2014) and may contemplate the possibility of delegating the management of the SCR's investments to a management company. SCRs must have a minimum subscribed capital of €1.2 million (€900,000 for ECRs-Pyme) on the date of their incorporation, 50 per cent of which must be paid up on such date.

SGEICs shall have a minimum capital of €125,000, which shall be subscribed and fully paid up on the date of incorporation. Such amount shall be increased if the portfolio under management exceeds €250 million, in accordance with article 47 of Law No. 22/2014.

Establishment costs of ECRs generally include legal advisers' fees, notary fees and registrar fees. ECRs must be audited. Additionally, as described in question 17, no capital duty shall have to be paid on the incorporation or capital increase of ECRs. Management services rendered by SGEICs to their managed ECRs are VAT-exempt.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

As mentioned, FCRs must be managed either by an SGEIC or by an SGIIC. SCRs are corporations that may be self-managed, or may delegate their management to an SGEIC or an SGIIC. As any other corporation, an SCR will be required to maintain locally a registered office and books and records and, additionally, office space, IT equipment and human resources sufficient to properly carry out its regulated activity, as determined by the CNMV.

It is the SGEIC or the SGIIC who must ensure that the FCR, or the SCR managed by it, meets certain requirements in relation to human, technical and material resources, rather than the ECRs themselves. SGEICs and SGIICs must have a registered office (which will also be the registered office of the FCR), a board of directors and a minimum number of employees (which will vary depending on the number of ECRs managed by them, the assets under management and the number of foreseen investments). SGEICs and SGIICs must also keep their own books and records.

SGEICs shall appoint a depositary in relation to each of the ECRs managed by them if the assets under management exceed the limits established in article 72.1 of Law No. 22/2014 or if the SGEIC commercialises ECRs to non-professional investors.

SCRs shall be managed by a board of directors, which must have a chairperson and a secretary (who may be a board member or not).

Annual accounts of ECRs must be prepared by the board of directors of the SCR, the SGEIC or the SGIIC, within five months of the end of the financial year, and then submitted to the general shareholders meeting for approval within six months of the end of the financial year. In general, the financial statements of ECRs and SGEICs, which have to be audited, must be filed with the CNMV and, in the case of SCRs and SGEICs, also before the Spanish Mercantile Registry within seven months of the end of the financial year.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The transparency requirements relating to ECRs are regulated in section 3a of Law No. 22/2014. In addition, in December 2013, the Spanish Congress approved the Law on Transparency. Pursuant to it, entities controlled by public administrations, corporations majority-owned by public administrations or companies that are recipients of government subsidies, will be subject to certain disclosure obligations.

Generally, FCRs' constitutional documents and modifications are available to the public, as they are filed with the CNMV's registry, which is available to the public.

An SCR's deeds of incorporation and their by-laws must also be registered with the Mercantile Registry, which is also available to the public.

Investors subscribing to units of an FCR on the date of its incorporation will appear in the constitutional documents, and therefore their identities and the amount of their investment will be available to the public. The same will apply to investors subscribing to shares of an SCR, not only on the incorporation of the SCR but also upon each subsequent capital increase.

An ECR's annual accounts must be audited and are available to the public. The audit report and the audited annual accounts have to be filed with the CNMV. The same applies for SCRs, except that the filing should also be made with the Mercantile Registry.

The annual report of the SGEICs shall include information relating to the remuneration policy of the SGEIC. An SGEIC shall file its audit report and accounts with the CNMV within six months of the end of the financial year.

Failure to comply with these obligations may entail monetary sanctions and, in certain cases, may even result in the revocation of the CNMV's authorisation and exclusion of the ECR from the relevant CNMV registry.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Generally, the liability of investors with respect to their investment in an ECR is limited to the share capital subscribed or to the units acquired, and such limited liability is respected under Spanish law. Under very exceptional circumstances, Spanish courts may approve the 'piercing of the corporate veil' of an SCR and agree that the shareholders of the SCR be held liable for the SCR's liabilities.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

SGEICs and self-managed SCRs must prepare and approve a mandatory internal code of conduct, that regulates the operation of their management bodies, directors and employees. Such code of conduct shall develop the principles established in the consolidated version of the Spanish Securities Market Law (Law No. 24/1988).

Directors of an SGEIC or SGIIC and directors of SCRs are subject to the following obligations:

- to act with due diligence and transparency for the benefit of investors;
- to prevent and avoid risks derived from conflicts of interest, or to regulate appropriate procedures to ensure that if any conflict arises, priority is given to the interest of the investors;
- to undertake prudent management, and to take care of investors' interests as if they were their own interests; and
- to ensure that all investors are treated fairly.

Generally, such duties cannot be modified by agreement between the parties.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

As described in question 6, directors and officers of ECRs and their management companies are required by law to undertake prudent

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management and to take care of the investors' interests as if they were their own interests. Additionally, Spanish corporate law provides for a strict regime on directors' liability under which directors of an ECR management company (or directors of an SCR) may be held liable towards the company, its shareholders or third parties if they do not act as a prudent business person or as a loyal representative.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

ECRs are required by Law No. 22/2014 to invest at least 60 per cent of their assets in equity or equity-related instruments (including, subject to certain limits, profit-sharing loans). Investments in certain real estate companies, financial entities or listed companies (other than public-to-private transactions) will not qualify within the mentioned 60 per cent.

The remaining assets may be invested in the share capital of other companies, profit-sharing loans, other types of financing to portfolio companies or certain other securities (although proceeds from such investments would not benefit from the special tax regime for ECRs as further described in question 17).

Additionally, ECRs are subject to certain diversification and borrowing limits.

As explained in question 1, ECRs-Pyme must invest at least 75 per cent of their assets in equity or equity-related instruments in small and medium-sized entities (ie, those entities that fulfil the requirements outlined in question 1).

Generally, conversion or redomiciling of foreign private equity funds into ECRs would not be possible as such. An application to obtain the CNMV's authorisation or approval for registration would have to be submitted under the form of an SCR or FCR. Documentation governing FCRs may include most of the standard market terms and conditions governing private equity funds, such as investment restrictions, investors' governance rights, transfer restrictions, reporting provisions, distribution waterfall, etc. However, some difficulties may be found in implementing certain market terms in an SCR, as it is a corporate entity in which shareholders have substantial rights to interfere with the management. Also, there would be some difficulties in reflecting usual opt-out or exclusion provisions as, in principle, investors should participate in each of the ECR's assets and liabilities, pro rata to their participation in the capital of the ECR.

Finally, Law No. 22/2014 regulates the European venture capital funds and the European social entrepreneurship funds, institutions formed under the European Parliament and Council Regulation No. 345/2013, dated 17 April 2013, and the European Parliament and Council Regulation No. 346/2013, dated 17 April 2013, respectively, and that now have to be registered with the CNMV.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

In general terms, the bankruptcy, insolvency, change of control, restructuring or similar transaction affecting an ECR sponsor should not have, per se, direct legal or regulatory consequences for the ECR.

The bankruptcy or insolvency of the ECR's management company may have relevant consequences for the ECR, which either should replace the management company or be liquidated itself (article 57 of Law No. 22/2014).

Finally, under article 53 of Law No. 22/2014, the ECR's authorisation may be revoked, among other circumstances, when the ECR is declared bankrupt or insolvent or it can be reasonably considered by the CNMV that the influence exercised over the ECR by an investor holding a relevant stake in such ECR may be detrimental to the ECR's proper and prudent management and could potentially result in severe damage of its financial situation.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The CNMV, as the main supervisory and regulatory authority, and the Bank of Spain (with respect to anti-money laundering obligations) are the principal regulatory bodies of ECRs and have very wide inspection rights within their respective authority and functions.

The CNMV must be notified of changes in the documents submitted to the CNMV within the authorisation and constitution process, including changes related to directors and top executives of the ECR or its management company (some of these changes may require the CNMV's prior approval). Also, the CNMV must be regularly provided with accounting information, which has to be submitted to the CNMV in the way of annual accounts after the end of the fiscal year to which they refer, as well as the managers having to provide the CNMV with different documents containing certain economic information related to the ECRs managed by them including the audited annual accounts.

Without prejudice to the above, when, as provided in article 72 of Law No. 22/2014, the management company or the assets of the ECRs managed by it exceed certain size limits (€100 million for leveraged funds and €500 million for unleveraged funds) or are marketed between non-professional investors, additional reporting requirements may apply to investors and regulators, with the following being the most relevant:

- an annual report for investors and the CNMV to be provided no later than six months after the end of the year;
- the audited annual accounts of the management company and the ECR no later than six months after the end of the year;
- any new measures to manage liquidity as well as any changes in the leverage and guarantees policy of the ECR;
- reports regarding the leverage of the ECR; and
- information regarding the acquisition of significant stakes in non-listed companies not considered small or medium-sized companies.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

As previously stated, ECRs must be registered with the CNMV and only self-managed SCRs require the CNMV's administrative approval prior to its registration. SCRs, prior to its registration with the CNMV, must be incorporated in a notarial public deed and registered with the Mercantile Registry. Incorporation in a notarial public deed and registration with the Mercantile Registry is not required for FCRs.

The level of investment activity ECRs may have in Spain would not directly make any difference in relation to its registration requirements, although, in order for a new ECR to obtain the regulatory registration (or authorisation in the case of a self-managed SCR), such level of investment activity will be taken into account by the CNMV in order to ascertain the minimum human and material resources that the SCR, SGEIC or SGIIC should reasonably have to perform proper management and administration.

Following the above, it must be noted that ECRs or management companies whose ECRs exceed certain size limits or are marketed to non-professional investors, are subject to a more complex and stringent regulatory regime and higher structure requirements, including, specific remuneration policies, conflict of interests procedures, risk management procedures and units, liquidity management systems,

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periodic asset valuation (by internal or external valuers) and additional information requirements, etc.

Therefore, in order to authorise or register (as applicable) these types of ECRs and management companies, the CNMV will usually request more detailed information regarding said matters as well as a higher degree of human and material resources.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

ECRs and their management companies are registered and supervised by the CNMV, and they are expressly authorised to provide advisory services to entities within the scope of their corporate activity. Consequently, they do not need, for these purposes, to begin a different procedure to register as investment advisers. Directors and officers of SGEICs, SGIICs and SCRs are also subject to regulatory supervision as part of an ECR management company and, therefore, for such purposes, do not need to be registered as investment advisers either.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

The board of directors of both SGEICs and SCRs must have a minimum of three directors. The directors and officers of SGEICs and of SCRs must meet certain requirements regarding integrity and reputation. In this respect, they must complete a specific form and questionnaire required by the CNMV. Additionally, the CNMV will require that the directors and officers of SGEICs or SCRs have appropriate knowledge and experience regarding financial or business management. In principle, such experience should include, as a minimum, three years of management or advisory services to financial entities or executive management posts in other public or private companies.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are substantial restrictions under Spanish law in relation to political contributions by individuals or private entities to political parties. Political parties may not accept contributions from private businesses that provide services to public administrations or companies majority owned by public administrations. Additionally, annual contributions to political parties by an individual or private entity cannot exceed certain very stringent thresholds.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

Usually, the CNMV will request that the management company includes in the ECR's prospectus the name, if any, of the intermediaries that are marketing the ECR. Likewise, the CNMV may ask or request additional information from the management company or the sponsors during the ECR approval procedure regarding the use of intermediaries or placement agents for the marketing of the relevant ECR. Finally, please note that, in general terms, intermediaries that wish to market or place an ECR among investors must be previously authorised to act as financial intermediaries in Spain pursuant to the applicable legislation.

At the moment, no legislation relating to any register of lobbyists has been approved in Spain.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

With the exception of the potential implications deriving from the implementation of the Alternative Investment Fund Managers Directive (AIFMD), as well as potential implications that the Volcker Rule and Basel III may have on Spanish banks, no other regulations may have a material impact with respect to banks investing in or sponsoring private equity funds.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Spanish ECRs are non-transparent entities and, therefore, are subject to Spanish corporate income tax (CIT).

In general terms, pursuant to the CIT general tax regimen (article 21 of the CIT Act), entities subject to CIT will benefit from a full exemption on dividends and gains obtained from their participation in resident and non-resident companies (except tax haven companies), when the following requirements are met:

- that the participation is held for at least a year and represents at least 5 per cent of the investee company (or its acquisition value is over €20 million); and
- in the case of stakes in non-resident investee companies, that said companies be subject to a CIT that applies at least a 10 per cent tax rate (presumed to be the case if resident in a country that has a double tax treaty with Spain with an information exchange clause).

Notwithstanding the above, pursuant to article 50 of the CIT Act, ECRs do enjoy an even more privileged tax regime on dividends and gains derived from 'typical' or 'qualified investments' (as set out by Law No. 22/2014 regulating ECRs), and also with respect to distributions made to Spanish corporate investors and non-resident investors (except tax haven investors).

The main features of the special CIT regime applicable to ECRs can be summarised as follows.

ECR special tax regime under Spanish corporate income tax

Dividends and gains obtained by an ECR from 'typical investments' in accordance with article 2 of Law No. 25/2005 regulating ECRs (generally, investments in non-listed companies – other than public to private transactions – either Spanish or non-Spanish that do not qualify as financial or real estate entities) will be subject to the ECR special tax regime pursuant to Chapter IV of Title VII of the Spanish CIT Act, which states the following:

- gains that do not qualify for the article 21 CIT Act full exemption that are obtained by the ECR from the transfer of securities representing a participation in the share capital of the investee company (considered as an ECR typical investment) will benefit from a 99 per cent CIT exemption at the level of the ECR, provided that the investment holding period is longer than one year and does not exceed 15 years (subject to the approval of the Spanish Tax Authorities, this term may be extended to up to 20 years in certain cases), except in the event that said participation does not meet the criteria set out in article 21 of the CIT Act and the following is true:
  - the acquirer is resident in a tax haven jurisdiction or the gain is obtained through a tax haven;

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- the acquirer is to be considered related to the ECR pursuant to the CIT Act (unless it is another ECR); or
- the participation was acquired by the ECR to a related person or entity pursuant to the CIT Act; and
- dividends obtained from said Spanish resident or non-resident investee companies (except if obtained through a tax haven) will benefit at the recipient ECR level from the full tax exemption contained in article 21.1 of the CIT Act, regardless of the investment holding period and the percentage stake held in the company paying out the dividend.

When the investments executed by the ECR are not considered as ECR typical investments, the gains and dividends obtained from them will be taxed at the level of the ECR in accordance with the general tax regime established in the CIT Act. Therefore, although the ECR will not benefit regarding these investments from the above-mentioned ECR privileged tax regime, the ECR may be able to benefit from the general tax credits and exemptions applicable pursuant to the CIT Act (eg, article 21 of the CIT Act). Likewise, interest, royalties and any other income that does not qualify as dividends, distribution of profits or gains from ECR typical investments will be subject to the CIT general regime at the ECR level.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Income obtained by non-resident entities or individuals without a permanent establishment in Spain, deriving from their participation in the ECR (ie, dividends, distribution of benefits or capital gains from the reimbursement or transfer of their stake in the ECR, but excluding interests or other types of income) will not be considered to have been obtained in Spain for Spanish tax purposes and, consequently, will not be subject to taxation in Spain (articles 50.3 and 50.4 of the CIT Act). Notwithstanding the above, in general terms, if the income or gains are obtained through a tax haven jurisdiction or when the acquirer is a tax haven resident, this special tax treatment shall not apply (article 50.5 of the CIT Act). Pursuant to the above, non-resident investors may have to provide the ECR with a tax residence certificate to ascertain their proper non-resident status.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

The ECRs' special tax regime is expressly regulated by the Spanish tax law and applies to all ECRs duly registered in the Spanish CNMV; therefore, its application is not subject to a tax ruling. However, an investor may request from the Spanish tax authorities the issuance of a ruling to confirm or clarify any doubt or question regarding the application of the Spanish ECRs' regime or any other Spanish tax laws or regulations.

Tax treatment of companies resident in Spain, investing in ECRs

Spanish resident companies subject to CIT investing in ECRs will benefit from the ECR special tax regime (articles 50.3 and 50.4 of the CIT Act) as follows:

- for gains obtained from the transfer or redemption of ECRs' shares or units – the Spanish CIT investor will benefit from the tax exemption contained in article 21.3 of the CIT Act regardless of the holding period and the percentage stake held in the ECR (article 50.4 of the CIT Act); and
- for dividends and benefits distribution, the Spanish CIT investor will benefit from the tax exemption contained in article 21.1 of the CIT Act, regardless of the holding period and the percentage stake held in the ECR (article 50.3 of the CIT Act).

Tax treatment of individuals resident in Spain, investing in ECRs

No particular tax regime applies with respect to individuals resident in Spain investing in ECRs, who will be subject to the general Spanish personal income tax regime.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

At present, there is no capital duty applicable on the establishment or capital increase of ECRs or any other Spanish company. However, capital duty may be due in the case of a share capital reduction or winding-up of a private equity company that results in distributions to its investors (generally, 1 per cent over the amount obtained by investors).

Notwithstanding the above, the use of adequate tax planning may help to reduce said capital duty. Finally, the registration of the ECRs in the CNMV registries is currently subject to registration fees.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Regarding an ECR management company, management fees obtained by it from the management service provided to an ECR are exempt from VAT. Therefore, generally, VAT borne by an ECR management company will not be deductible (or may be partially deductible only), depending on the VAT pro rata applicable to the ECR management company, taking into account the services provided to other parties subject to VAT.

If, apart from the ECR management company, there are other sponsors or third parties that provide administration or advisory services to the ECR, such services may be subject to VAT depending on the nature of the services provided, which may result in tax inefficiencies.

Apart from the above and regarding CIT, the ECR management company is subject to the general CIT regime and therefore its annual benefits are taxed under Spanish CIT regular tax rates (25 per cent being the standard tax rate).

With regard to carried interest, depending on the circumstances, it may be structured either as a success fee payable to the ECR management company (and by the latter to its employees), or as a return from the investment made by the management company or sponsors or promoters, in the ECR.

Should the carried interest be structured as a return from an investment made by the founding sponsors or promoters of the ECR, they shall subscribe and make a relevant contribution to the ECR. In this case, depending on the circumstances and only if properly structured and justified, the returns received by the founding sponsors from their participation in the ECR may benefit from the capital gains or dividends tax treatment described above.

If carried interest was paid as a salary compensation to an employee of the SCR or of the ECR's management company, it may be treated, depending on the circumstances, either as a regular salary income (paying around 43–48 per cent under personal income tax rules, depending on the region where the Spanish manager is tax-resident) or, up to an annual maximum of €300,000, as an irregular salary income that may benefit from a 30 per cent reduction on the basic tax.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Spain has a wide tax treaty network with third countries. In particular, Spain currently has double tax treaties in force with the following countries: Albania, Algeria, Andorra, Argentina, Armenia, Australia, Austria, Barbados, Belgium, Bolivia, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cuba, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Finland, states of the former USSR (except Russia), France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mexico, Moldova, Morocco, New Zealand, the Netherlands, Nigeria, Norway, Oman, Pakistan, Panama, Philippines, Poland,

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Portugal, Romania, Russia, Saudi Arabia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Africa, Sweden, Switzerland, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela and Vietnam.

This extensive tax treaty network provides the ECR with a significant advantage when structuring investments in foreign companies in a tax-efficient manner.

As described above, income obtained by non-resident investors (other than tax haven investors) from an ECR (ie, dividends, distribution of benefits or gains, but excluding interests or other types of income) is, generally, considered not to have been obtained in Spain for tax purposes and, consequently, not subject to taxation in Spain, whether or not there is a tax treaty in force with Spain.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

The Spanish special tax regime applicable to ECRs contains a number of anti-abuse rules applicable to transactions made by ECRs with related entities, and to transfers to tax-haven residents, which may result in the non-application of the ECRs' special tax regime to certain transactions. Said rules must be considered when planning a deal with related parties or involving tax haven residents, parties or accounts.

Finally, ECRs may also be entitled, if they meet the corresponding requirements, to other tax regimes, deductions, exemptions and incentives generally applicable to Spanish CIT payers – or even to Spanish individual investors.

In summary, all of the above makes the ECR regime a very competitive one for setting up private equity funds, to raise money and to invest in Spain and abroad (as the ECRs privileged tax regime applies with respect to both Spanish and non-Spanish investments), and it is also very favourable for Spanish corporate investors and foreign investors in ECRs.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

ECR marketing rules and requirements are regulated under Law No. 22/2014.

ECR interests may only be marketed to the following persons or companies:

- professional investors as defined in article 205 of the consolidated version of the Spanish Securities Market Law (Law No. 24/1988);
- non-professional investors who commit to invest at least €100,000 and declare in writing that they are aware of the risks related to such investment;
- directors, executives or employees of its management company or the ECR itself; and
- investors who prove to have experience in the investment, management or advisory to similar ECRs to the ones they wish to invest in.

However, these restrictions will not apply to investors investing in listed ECRs. When the ECR is marketed to non-professional investors, the investor must receive, prior to investment, an information prospectus that shall include, among other information, the by-laws or management regulations of the ECR, the management company agreement and the ECR annual report. These documents will be filed before the CNMV and included in the CNMV registries. Likewise, the management company of ECRs that are marketed to non-professional investors will have to comply with the additional regulatory requirements set out in Title II of Law No. 22/2014 for management companies that exceed certain ECR assets under management thresholds (€100 million for leveraged ECRs and €500 million for non-leveraged ECRs), even if they do not exceed them.

The marketing of foreign private equity funds in Spain is also regulated under Law No. 22/2014 by different rules depending on the place of incorporation of the foreign private equity fund and its management company and their legal status pursuant to Directive 2011/61/EU. In general terms, the marketing of EU private equity funds managed by an EU management company to professional investors that have requested to avail from the passport regime in Spain shall require: a previous notification by the corresponding EU country supervisor to the CNMV, including the main documents and information of said EU private equity fund; and the payment to the CNMV of fees to process the passport file and an annual supervisory fee. The marketing to non-professional investors or of any other type of private equity funds will require the compliance of additional requirements and their previous registration and authorisation by the CNMV.

Finally, all foreign private equity funds and their management companies marketed in Spain shall comply with the marketing and publicity regulations applicable in Spain for this type of investment.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Apart from the restrictions established above, it must be noted that certain Spanish institutional investors, because of their own regulatory restrictions, may not be able to invest in non-listed ECRs or may find such investment subject to stringent investment restrictions or limitations (for example, Spanish pension funds and certain Spanish collective investment schemes).

Additionally, the unfavourable tax treatment applicable to tax haven residents investing in ECRs has discouraged their direct investment in ECRs.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The CNMV requires the previous notification of the identity of all direct or indirect shareholders of ECR management companies or self-managed ECRs and any subsequent ownership changes. Regarding ECR investors, although a specific obligation is not expressly provided by law, given its broad supervisory powers, the CNMV can request any ECR management company to provide information about its direct or indirect investors.

Additionally, the appointment or dismissal of managers and directors of an ECR management company or of an SCR must be notified to the CNMV as well as the appointment, removal or replacement of the ECR management company itself, and any other material change in relation to the documents approved by the CNMV in the process of approval of the ECR or of its management company.

Finally, as a consequence of the recent implementation under Spanish Law of FATCA and CRS (OECD Common Reporting Standard) regulations, the management company may have to disclose the identity of foreign investors who meet the relevant FATCA and CRS criteria to the Spanish authorities.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Yes, the offering of interests in an ECR can only be performed by financial intermediaries as provided by Law No. 22/2014 and its regulations.

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Update and trends

The bill implementing Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, amending Directive 2002/92/EC and Directive 2011/61/EU (the MiFID II Directive) and replacing the Spanish Securities Market Law (Law No. 24/1988) will be discussed in the Spanish Congress over the coming months, and it is expected that it will come into force several months after the MiFID II Directive implementation deadline of 3 January 2018. According to the proposal approved by the Spanish government on 2 December 2017, which is pending submission to the Spanish Congress, stringent controls on fee retrocessions and a complete ban on inducements will be imposed. These changes will require Spanish banks, investment brokers and collective investment managers to adapt their private equity funds distribution policies. Spanish investment management associations and banks are lobbying against such changes to allow for more flexibility, but it has yet to be seen if such efforts will be successful.

Despite the above regulatory changes, given the ongoing low interest rate scenario in Europe, banks and other financial intermediaries have been very active offering private equity fund investments to private banking clients and retail investors. This has produced an increase in the number of private equity managers that have decided to voluntarily submit to the application of Chapter II of Law No. 22/2014 in order to be able to market their funds among retail investors, and this decision has entailed an increase in the number of Spanish managers that have had to adapt to the full AIFMD regime and of third-party fund administration services providers.

After having announced the Fond-ICO 9th public tender, a fund of funds promoted by the Spanish government and ICO in 2013, and which has had a very positive effect on the Spanish private equity market, ICO has confirmed that Fond-ICO will run out of dry powder during 2018 and that during the second semester of the year it will be considering different options for continuing with this public initiative.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

ECR management companies and self-managed SCRs are subject to a number of money-laundering prevention obligations, including the following:

- approving and complying with a money-laundering prevention handbook drafted in accordance with the anti-money laundering regulations in force;
- duly identifying each investor in the ECR management company or the ECR, and keeping records of the investors' identification documents as well as of the transactions;
- complying with the relevant FATCA and CRS regulations and filings as implemented under Spanish law;
- training its directors and employees in the relevant money-laundering prevention procedures and handbook;
- reporting any suspicious transaction or investor to the Bank of Spain; and
- having an annual independent expert provide reports regarding compliance with money laundering obligations.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

A securities and exchange market (MAB) was established in 2006 in order to facilitate the listing of collective investment schemes incorporated as companies, small and medium-sized companies and other particular entities (for example, ECRs) whose specific characteristics (such as liquidity and size) would make their listing difficult in the regular Spanish Stock Exchange. In June 2007, the MAB market opened a specific segment for the listing of ECRs although, so far, only one ECR has been listed.

The principal and continuing requirements for listing are as follows:

- the MAB will obtain the pertinent documentation from the CNMV's registries, including the ECR's annual report and prospectus;
- the ECR must appoint a specialised entity as responsible for the ECR's shareholders' or unitholders' register;
- the ECR shall inform of the liquidity and counterparty commitments reached with a MAB member or participating entity in their capacity as a specialist in the securities issued by the ECR;
- the ECR must undertake to send to the MAB any relevant information that might affect trading of its shares, in accordance with applicable legislation and market regulations; and
- the MAB board of directors shall authorise the admission to trading of the ECR's securities.

The main advantages for trading are enhanced liquidity, a more efficient and secure transfer of shares, increased transparency and broadening of the investor base (including access to certain institutional investors who may be subject to regulatory restrictions to invest in non-listed ECRs).

The main disadvantages of listing are the administrative and regulatory costs derived from such listing, the increase of information, accounting and filing obligations, and the difficulties in establishing, on a regular basis, a valuation and liquidation price for the ECR's securities.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

The restriction on the transfer of securities in listed ECRs is, in general terms, not allowed by the MAB market authorities.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

As explained in questions 1 and 8, an ECR must invest at least 60 per cent of its assets or 75 per cent for ECRs-Pyme in certain equity or equity-related instruments in companies, other ECRs or foreign private equity funds that meet certain requirements (including, subject to certain limits, profit-sharing loans). Investments in certain real estate companies, in financial entities or in listed companies (other than public-to-private transactions) will not qualify within the mentioned 60 per cent. The remaining assets, up to a maximum of 40 per cent, may be invested in the share capital of other companies, profit-sharing loans to any company, other types of financing but only to companies included in its main corporate purpose, fixed income securities or cash. Likewise, the Spanish special tax regime applicable to ECRs contains a number of anti-abuse rules applicable to transactions made by ECRs with related entities, and to transfers to tax haven residents, which may result in the non-application of the ECRs' special tax regime to certain transactions.

In addition to the above, article 71 of Law No. 22/2014 has included certain additional information requirements and restrictions to ECRs and their management companies that exceed the size limits or are marketed to non-professional investors as described in question 10, regarding the acquisition and holding of stakes in entities not considered to be small and medium-sized companies, such as the following:

- the obligation to notify to the CNMV of the acquisition of any relevant stake (10, 20, 30, 50 or 75 per cent and above) either individually or together with other private equity funds in companies;
- the obligation, when said stake acquired is higher than 50 per cent, to inform the CNMV, the company and its shareholders of the following:
  - the ECR identity;
  - the ECR conflict of interest and communications policy;

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  - the terms of the financing used for said acquisition; and
  - the ECR intentions regarding the future activities of the company and their consequences or implications in the company's employment; and
- the prohibition, when said stake acquired is higher than 50 per cent and for a period of 24 months, to approve certain share capital reductions, as well as, depending on the net asset value and balance sheet situation of the company, certain dividend distributions or the acquisition of the company's shares by the company.

Other than the above, there are no particular legal or regulatory restrictions that would normally affect or prevent an ECR's participation in private equity transactions.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

An ECR may pay management fees and success fees as compensation for the management services provided by its management company as long as such fees have been duly regulated in the ECR's constitutional documents. Although the management company may also charge transaction fees, monitoring fees or other similar fees if they are established in said documents, it is best market practice that any such fees would give rise to offset management fees. The ECR management company may also receive fees for the rendering of advisory or other services, on an arm's-length basis, to portfolio companies or prospective portfolio companies, although pursuant to market practice, the provision of such services is usually subject to some kind of investors' consent, or at least, disclosure obligations.

As for profit-sharing arrangements other than success fees, ECRs may issue different classes of units or shares, and therefore different profit-sharing compensation schemes can be structured through the investment in such units or shares.

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The two main legal vehicles available in Switzerland for private equity investments are the Swiss limited partnership (the Swiss LP) and the Swiss investment company with fixed capital (the SICAF). The applicable legal and regulatory framework is enshrined in the Collective Investment Schemes Act of 23 June 2006 (CISA), its implementing ordinance of 22 November 2006 (CISO) and the Swiss Financial Market Supervisory Authority (FINMA) ordinance on collective investment schemes of 27 August 2014 (FINMA-CISO). Following international developments and notably the adoption of the EU Alternative Investment Fund Managers Directive, the Swiss rules applicable to the management, custody and distribution of collective investment schemes have been the subject of a complete overhaul. In September 2012, the Swiss parliament adopted a revised CISA, which entered into force on 1 March 2013 along with the revised CISO.

The Swiss LP

The Swiss LP is a collective investment scheme that is specifically aimed at alternative investments, private equity investments and real estate projects and that has been designed to mirror the legal form of certain offshore limited partnership structures. The Swiss LP is subject to the supervision of FINMA. As a rule, the Swiss LP is a closed-ended investment scheme, meaning that the investors do not benefit from a redemption (namely, exit) right. The Swiss LP benefits from a quasi-legal personality and, as such, is entitled to hold assets or claims.

The Swiss LP is managed by one or more general partners (GPs) with unlimited liability for the commitments of the Swiss LP. The GP may delegate certain tasks to third parties to the extent that such delegation is in the best interest of the Swiss LP. The asset management function may, however, only be delegated to a regulated investment manager of Swiss collective investment schemes.

The investors in the Swiss LP are the limited partners. They may not be involved in the management of the Swiss LP, which is of the exclusive competence of the GP (see also question 5). That being said, the limited partners benefit from extensive information rights as well as certain governance rights, such as the delivery of periodic financial information on at least a quarterly basis as well as information on the financial accounts at any time. The Swiss LP is only open to qualified investors (see question 24 for the definition of this concept and for exceptions to this general rule).

The partnership agreement of the Swiss LP sets out the key rules that apply among the GPs and the limited partners. Swiss law allows a significant freedom to the parties in the regulation of their relationship in the partnership agreement, subject to a limited set of contractual provisions, which are required as a matter of law.

The Swiss LP must appoint a Switzerland-based independent auditor (see question 10) and a depository and paying agent. The designation of a custodian bank is not required (see question 2).

The SICAF

The SICAF is a Swiss company limited by shares, whose corporate purpose is limited to the management of its own assets. The SICAF is not allowed to pursue any entrepreneurial activity. The regulatory framework set forth in the CISA as regards the SICAF is rather limited. The SICAF is substantially governed by the provisions of the Swiss Code of Obligations. The SICAF has a separate legal personality from its investors.

It is to be noted in this context that a SICAF is not subject to the CISA if its shares are listed on a stock exchange or its shareholders are exclusively qualified investors (see question 24).

To our knowledge, all Swiss SICAFs have so far relied on this regulatory safe-harbour and there is currently no Swiss SICAF that is regulated by FINMA. Consequently, the answers to this questionnaire will be limited to the Swiss LP.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

The formation of a Swiss LP presupposes an authorisation to be granted by FINMA. The application is to be reviewed by an audit firm recognised by the Federal Audit Oversight Authority (FAOA) (being noted that the audit firm in charge of reviewing the application is barred from acting as auditor of the Swiss LP). The authorisation is generally issued within a three to four-month time period, subject to FINMA's workload and in the absence of any unforeseen complications.

As regards fees, the initial registration fee levied by FINMA amounts to between 10,000 and 40,000 Swiss francs. In addition, FINMA levies a yearly supervision fee, which is computed on the basis of the assets of the Swiss LP.

The Swiss LP is not subject to any capital requirements. The minimum share capital of the GP is 100,000 Swiss francs, which must be fully paid up.

Finally, the Swiss LP must appoint a Switzerland-based independent auditor and a depository and paying agent.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

As indicated above, the Swiss LP is managed by the GP, which must be a Swiss company limited by shares with a registered office in Switzerland. The Swiss LP and the GP must establish financial statements in accordance with the provisions of Swiss law, in particular the FINMA-CISO. They are also subject to the record-retention obligations generally applicable under Swiss corporate law (generally speaking, corporate records shall be kept for a period of 10 years, which starts running at the end of the business year to which each document refers). In turn, Swiss law does not require the appointment of a corporate secretary for the Swiss LP or for the GP.

Furthermore, as indicated above, the Swiss LP must appoint a depository and paying agent, but the designation of a custodian bank is not required.

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4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The Swiss LP and the GP must be registered with the Swiss Register of Commerce. The excerpt of the Register of Commerce is available to the public and provides general information with respect to the Swiss LP and the GP (for example, capital, registered office, authorised signatories). Furthermore, the partnership agreement establishing the Swiss LP must be filed with the Register of Commerce and is therefore available to the public. The provision of such information is a prerequisite for the registration with the Register of Commerce.

As regards the investors (namely, the limited partners of the Swiss LP), the aggregate amount of their capital commitments (but not the names of the limited partners, nor the latter's commitments on an individual basis) is to be registered with the Register of Commerce and thus available to the public. By reviewing the partnership agreement, the public could also be in a position to ascertain whether the investors have made any additional financial commitments. Under Swiss law, the liability of the limited partners of the Swiss LP is capped at the amount registered with the Register of Commerce, but the limited partners may agree, in the partnership agreement, to make additional financial commitments.

In contrast, the financial statements of the Swiss LP are only available to the investors and not to the general public.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

As a matter of principle, the liability of the limited partners (namely, the investors) is capped at the amount of the capital contribution registered in the Register of Commerce. The limited liability of the investors can, however, be disapplied in the event the investors are involved in the management of the Swiss LP. In other words, a limited partner who or which is involved in the management of a Swiss LP may face an unlimited liability for the commitments of the Swiss LP (as is the case for the GP; see question 1).

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The Swiss LP is managed by the GP. The liability of the GP as regards the limited partners depends upon the provisions of the partnership agreement. As a matter of principle, it should be possible to insert in the partnership agreement a provision that would limit the liability of the GP towards the limited partners (for example, providing for a liability only in the event of gross negligence and wilful misconduct). It is to be noted, however, that the model documentation for a Swiss LP, which has been developed jointly by the Swiss Funds and Asset Management Association (SFAMA) and the Swiss Private Equity and Corporate Finance Association and acknowledged by FINMA, does not contain any provision limiting the liability of the GP.

Under the CISA, the GP fiduciary duties include loyalty, due diligence and information duties (see question 32). These are specified in the SFAMA Code of Conduct, which has been recognised as the minimum standard by FINMA. According to this Code of Conduct, all CISA authorisation holders are to formalise their fiduciary duties in internal guidelines.

The above would also apply in the context of the asset management agreement that could be entered into between the Swiss LP and a third-party investment manager, if the GP has decided to delegate the asset management function to a regulated investment manager of Swiss collective investment schemes (see question 1).

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Swiss law distinguishes between 'gross negligence' and 'ordinary (or simple) negligence' in the context of the assessment of the validity of liability exclusion clauses.

In a nutshell, under Swiss law, a contractual exclusion of liability for 'gross negligence' or for 'wilful misconduct' is not enforceable. In turn, an exclusion of liability for 'simple negligence' is valid. That being said, the validity of an exclusion of liability for 'simple negligence' may be subject to judicial review, in the event the beneficiary of such exclusion is conducting 'commercial activities under an official licence' (pursuant to the case law of the Swiss Supreme Court, this applies, for instance, to banks). There is a risk that a Swiss court would consider that a GP (or a regulated investment manager) is conducting 'commercial activities under an official licence' and would thus review the validity of a liability exclusion for simple negligence.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The minimum number of investors in a Swiss LP has been set at two investors. The Swiss LP is only open to qualified investors (see question 24). A Swiss LP can, however, also be formed as a single investor fund, provided said investor is either a regulated insurance company or a public entity or pension fund with professional treasury management.

The partnership agreement regulates, among other things, the restrictions on the transferability of the interests, the expulsion of a limited partner in certain circumstances (for example, if the limited partner no longer meets the requirements of a qualified investor) and the possibility for the general meeting to remove the GP.

As a matter of principle, the transfer of a non-Swiss collective investment scheme to Switzerland and the reincorporation as a Swiss LP should be feasible. In this context, the corporate documentation, and in particular the partnership agreement, must be adjusted to reflect the provisions of the CISA and to take into account the practice of FINMA. From a practical perspective, it is advisable that the partnership agreement mirrors as closely as possible the provisions of the model documentation referred to in question 6.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

From a Swiss regulatory perspective, there is no need for a Swiss LP to have a sponsor.

In practice, Swiss LPs can, however, be launched by, or closely associated with, financial groups. To the extent the Swiss LP benefits from a quasi-legal personality and the GP is a distinct legal entity, the latter should not be affected by a corporate event affecting the sponsor. That being said, such corporate event may have a reputational impact for the Swiss LP.

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Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

The Swiss LP and the GP are subject to ongoing supervision by FINMA. The Swiss authority benefits from extensive audit and inspection rights as regards regulated entities.

Furthermore, it is worth noting that the Swiss regulatory regime is based on a 'dual supervisory regime', which requires regulated entities to appoint a FAOA-recognised auditor. The task allocated to such auditor is to verify whether the regulated entity complies with all applicable legal, statutory and regulatory requirements. The auditor's findings are set out in a report, which is delivered both to the regulated entity and to FINMA (the long-form report).

The limited partners (namely, the investors in the Swiss LP) benefit from information rights, such as the delivery of periodic financial information on at least a quarterly basis as well as information on the financial accounts at any time.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

Both the Swiss LP and the GP must be authorised by FINMA. These authorisations are generally obtained through a single regulatory process. This authorisation requirement is triggered by the creation of the Swiss collective investment scheme, but not by the conduct of investment activities in Switzerland. In other words, a non-Swiss collective investment scheme would be in a position to make investments in Switzerland without being subject to a FINMA authorisation requirement. This presupposes that the non-Swiss collective investment scheme is not deemed to be centrally administered in Switzerland. Indeed, the 'central administration' of a collective investment scheme in or from Switzerland would result in the scheme being deemed a Swiss collective investment scheme, something that would trigger a registration requirement with FINMA.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

As indicated above, the Swiss LP is managed by the GP. The GP must obtain an authorisation from FINMA.

The GP may delegate the asset management function to a regulated investment manager of Swiss collective investment schemes. Such investment manager must obtain an authorisation from FINMA. Otherwise regulated financial intermediaries, such as fund management companies, banks, securities dealers and insurance companies, are exempted from the licence requirement.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

Requirements applicable to the GP

In order to obtain the authorisation as GP, the individuals controlling the GP and the qualified participants in the GP (namely, persons or entities owning 10 per cent or more of the capital or voting rights of the GP or who can materially influence it in any other manner) are subject to a fit and proper test (somewhat similar to the one applicable under Swiss banking regulations).

Requirements applicable to the investment manager

To obtain the required licence from FINMA, the investment manager of a Swiss or non-Swiss collective investment scheme must demonstrate that it fulfils a number of financial requirements (for instance, a fully paid-in share capital of at least 200,000 Swiss francs and compliance with capital adequacy requirements, capped at an amount of 20 million Swiss francs) and personal criteria (in particular a fit-and-proper test, somewhat similar to the one applicable under Swiss banking regulations).

CISA further requires non-Swiss managers of collective investment schemes having a branch in Switzerland to register with FINMA.

Registration of the Swiss branch is subject to the following:

- the non-Swiss asset manager being subject to 'adequate' supervision by its home regulator;
- fulfilment by the non-Swiss asset manager of specific financial and organisational requirements; and
- a cooperation agreement being in place between FINMA and the non-Swiss asset manager's home regulator.

Finally, a limited de minimis exemption is available to asset managers of non-Swiss collective investment schemes whose investors are 'qualified investors' (see question 24), provided they satisfy one of the following requirements:

- the assets under management (including leverage) do not exceed 100 million Swiss francs;
- the collective investment schemes:
  - have assets under management of below 500 million Swiss francs; and
  - are unleveraged and closed-ended (such as the Swiss LP) for a five-year period; or
- the investors are exclusively group companies.

According to the FINMA-CISO, the assets whose management is entrusted to third party managers are to be taken into account for the calculation of the above thresholds. The value of the assets under management is also to be determined, for each collective investment scheme, in light of the valuation rules provided in the legislation of the home jurisdiction of the collective investment scheme.

Asset managers of non-Swiss collective investment schemes who are exempt under the de minimis rule have, however, the possibility to 'opt-in' and apply for a licence with FINMA, provided their registered office is in Switzerland and a registration is required either by Swiss law or by the law of the jurisdiction in which the collective investment scheme is registered or distributed.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such rules in Switzerland. That being said, anti-bribery laws may apply.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no such rules in Switzerland that would apply to the Swiss LP or the Swiss GP. In turn, certain conflict of interest rules may apply to the intermediaries acting on behalf of Swiss pension funds.

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16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

There are no such specific rules in Switzerland. In particular, Switzerland has refrained from enacting the Volcker Rule.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Swiss LPs are typically viewed in a transparent manner from a Swiss corporate income tax perspective. They are thus generally not subject to Swiss corporate income taxes on their income or gains (except if they directly hold Swiss real estate situated in Switzerland).

The tax treatment of distributions made by Swiss LPs depends upon their nature. Capital gain distributions or capital repayments are not subject to any tax at a Swiss level. On the other hand, distribution of income (eg, dividends or interest) by the Swiss LPs, which do not correspond to distributions of capital gains realised by the funds or real estate income realised directly by the funds, are subject to a 35 per cent Swiss withholding tax. Said withholding tax applies to distributions to Swiss or foreign investors.

Foreign investors may qualify for an exemption from Swiss withholding tax under the affidavit procedure (exemption provided for by Swiss internal law irrespective of the applicability of a treaty). This requires that more than 80 per cent of the Swiss LP's assets are of a non-Swiss source and that the investors demonstrate (typically via their bank) that they are not Swiss residents.

The foreign resident investors may further qualify for a partial or total exemption from Swiss withholding tax in application of a double tax treaty existing between their country of residence and Switzerland. The relief is typically granted by way of reimbursement rather than by way of exemption.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

No. The only tax forms that may be required are those necessary to obtain an exemption or reimbursement of Swiss withholding tax (see question 17).

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

The laws and regulations applicable to Swiss LPs have now been clarified. It is usually not necessary to confirm in a ruling that a Swiss private equity fund (namely, the Swiss LP) will be treated as such for Swiss tax purposes. Investors that are Swiss residents are subject to ordinary income taxes on the ordinary income distributed by the Swiss LP. The value of their units in the Swiss LP is also subject to Swiss wealth taxes. Every year the Swiss Federal Tax Administration publishes a list indicating the taxable income per unit and the tax value per unit.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

No. See question 2 regarding the registration and supervision fees levied by FINMA.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Management fees and carried interest payments paid to the Swiss resident sponsor are typically viewed as ordinary income. If the Swiss LP is structured via a loan or a capital commitment structure, it may be possible to obtain a ruling from the tax authorities confirming that the units held by Swiss resident individual managers qualify as private assets. In such a case, sales of units and distributions of capital gains realised by the Swiss LP on these units would be characterised as tax exempt private capital gains.

It is, however, important to note that this is typically subject to the compliance with restrictive conditions (the loan commitment qualifies as a loan, the managers receive an arm's-length salary for their professional activities, etc). The practice of the tax authorities may further vary from one Swiss canton to another.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Switzerland has concluded double tax treaties with the following countries: Albania, Algeria, Argentina, Armenia, Australia, Austria, Azerbaijan, Bangladesh, Belgium, Bulgaria, Belarus, Canada, Chile, China, Colombia, Croatia, the Czech Republic, Cyprus, Denmark, Egypt, Ecuador, Estonia, Finland, France, Ghana, Germany, Georgia, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, the Ivory Coast, Jamaica, Japan, Kazakhstan, Korea, Kuwait, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Morocco, Mexico, Moldova, Mongolia, Montenegro, Norway, New Zealand, the Netherlands, Oman, Pakistan, Peru, the Philippines, Poland, Portugal, Qatar, Romania, Russia, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Taipei, Tajikistan, Thailand, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Ukraine, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela and Vietnam.

Swiss funds would typically not qualify as 'residents' as per the respective treaties.

An investor in a Swiss LP residing in a treaty country may obtain the reimbursement of Swiss withholding tax levied on distributions (if any). The reimbursement is typically granted in application of the 'other income' provision of the treaty. In certain cases, such as the Switzerland-Germany treaty, fund distributions are characterised as dividends (so that German investors may only qualify for a partial reimbursement of the Swiss withholding tax (reduction from 35 per cent to 15 per cent)).

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

No.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

One must distinguish between the restrictions applicable to the investors in a Swiss LP and the limitations that apply in the context of the distribution in Switzerland of interests in non-Swiss collective investment schemes, which have not been authorised for distribution to non-qualified investors in Switzerland.

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Investors in a Swiss LP

The investors in a Swiss LP (namely, the limited partners of the Swiss LP) must be qualified investors. Under the CISA, the concept of 'qualified investors' comprises the following categories of investors:

- regulated qualified investors:
  - regulated financial intermediaries, including banks, securities dealers, fund administration companies and managers of collective investment schemes, as well as central banks; and
  - regulated insurance companies; and
- unregulated qualified investors:
  - public entities and pension funds with professional treasury management (the concept of a 'professional treasury management' presupposes that the relevant entity has entrusted at least one qualified professional with the management of its financial assets on a permanent basis);
  - companies with professional treasury management;
  - independent asset managers, subject to certain conditions;
  - investors who have concluded a written discretionary asset management agreement, provided the following is true:
    - they do not exercise their right to 'opt-out' of the 'qualified investors' status; and
    - the agreement is entered into with a regulated Swiss financial intermediary (namely, those that are referred to as 'regulated qualified investors') or with an independent asset manager (subject to certain conditions); and
  - high-net-worth individuals (HNWI) and private investment structures created for HNWI that have requested, in writing, to be considered as 'qualified investors' (opt-in declaration), provided they, in addition, execute the following:
    - confirm that they hold a minimum net wealth of 5 million Swiss francs; or
    - establish that they have, based on their professional training and experience, the technical competence of a qualified investor combined with a minimum net wealth of 500,000 Swiss francs.

It is worth noting that private investment structures created for HNWI may qualify as qualified investor provided that the opt-in declaration form is signed by a person in charge of the administration of the structure. For the rest, private investment structures may also be considered as qualified investors if they benefit from a professional treasury management.

According to FINMA Circular 2013/9 on the distribution of collective investment schemes, independent asset managers may also be considered as qualified investors, subject to certain conditions and provided they undertake, in writing, to use any information or materials in relation to the collective investment scheme for the benefit of qualified investors only.

From a practical perspective, the limited partners will generally be required to confirm their status as qualified investors by signing a corresponding declaration on the subscription form for an interest in the Swiss LP.

Finally, the individuals controlling the GP may also invest in the Swiss LP (even if they do not meet the requirements of a qualified investor), provided the following is true:

- the possibility of such an investment is set forth in the partnership agreement;
- the investment is made using private assets of the concerned individuals; and
- the investment is made at the time the Swiss LP is launched.

Distribution of non-Swiss collective investment schemes not authorised for distribution to non-qualified investors in Switzerland

Under the CISA, any offer or advertisement for collective investment schemes, which is not exclusively directed towards regulated financial intermediaries (such as banks, securities dealers or insurance companies), is, as a rule, construed as a regulated activity (defined as 'distribution'), irrespective of it being public or not.

As a result, the distribution of non-Swiss collective investment schemes to Swiss-based unregulated qualified investors is in principle subject to a licensing requirement under the CISA. Whereas Swiss distributors must be licensed by FINMA, foreign distributors of non-Swiss collective investment funds are required to be subject to appropriate supervision in their country of establishment (ie, have a regulated status that allows them to distribute collective investment schemes in their own jurisdiction). The collective investment scheme itself must appoint a Swiss representative with whom the foreign distributor is to conclude a distribution agreement, as well as a paying agent. The non-Swiss collective investment schemes themselves do not need to be approved by FINMA to be distributed to unregulated qualified investors in Switzerland. In contrast, the distribution of non-Swiss collective investment schemes to non-qualified investors is subject to FINMA's prior approval of the collective investment scheme at hand. It is to be noted that since 1 July 2014, distributors and promoters of collective investment schemes are to comply with the revised guidelines on the distribution of collective schemes of the SFAMA, which impose certain duties and provide for minimum provisions to be inserted in the distribution agreements concluded between foreign distributors and the Swiss representative of the foreign collective investment scheme (see question 27).

Limited exceptions from this distributor's licensing requirement are available under the CISA. They relate to the provision of information or the offer that takes place as follows:

- at the initiative of the investor, in relation to a specific fund and without any intervention or initial contact by the fund manager, distributor or representative of the collective investment scheme at hand (reverse solicitation);
- in the context of long-term onerous advisory agreements in place or as execution-only transactions; or
- within the context of a written discretionary asset management agreement entered into by the investor with a regulated financial intermediary (eg, a bank, a securities dealer or a fund management company) or with an independent asset manager (subject to certain conditions).

Another important exception applies to distribution activities targeting exclusively regulated financial intermediaries (such as banks, securities dealers, insurance companies), which do not trigger regulation under the CISA. Furthermore, 'outbound' cross-border distributions of non-Swiss collective investment funds to foreign qualified investors (as defined either under Swiss or foreign law) fall out of the scope of the CISA.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

As indicated in question 24, only qualified investors (and, under certain circumstances, the individuals controlling the GP) may invest in a Swiss LP. There are no additional restrictions on the types of investors.

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

In the case of a change in the circumstances on which the FINMA licence was based at the time it was granted, the Swiss LP must approach FINMA. Among other things, any change to the organisational structure and documents of the Swiss LP, any change in the persons responsible for the management and the business operations of the GP or any change in the qualified participants of the GP (namely, persons or entities owning 10 per cent or more of the capital or voting rights of the GP or who can materially influence it in any other manner) must be notified to, and respectively approved by, FINMA. In practice, these changes are notified in advance to FINMA in order to ensure its prior consent thereon.

As regards the limited partners (namely, the investors) of a Swiss LP, their identity is not to be communicated to FINMA. Furthermore,

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Update and trends

The regulatory framework applicable to collective investment schemes did not change in the past year. That said, one can expect a number of changes to the rules in the coming years. As things stand, two legislative instruments governing, on the one hand, the relationship between the financial intermediary and investors (ie, the Federal Financial Services Act) and, on the other hand, the relationship between the financial intermediary and the regulatory authority (ie, the Financial Institutions Act (FAFI)) are being reviewed at the legislative level. Both pieces of legislation could affect the legal regime applicable to Swiss LPs. The drafts are now being discussed in the Swiss parliament. As things stand, the entry into force of the two pieces of legislation is not expected before mid-2019.

Among other things, the draft FAFI provides for abolition of the licensing requirement for Swiss distributors. These would necessarily be private persons and would become subject to a duty to register in a new financial services providers register. In addition, the draft provides for certain restrictions to the provision of financial services and products on a cross-border basis, which might have indirect consequences for non-Swiss fund asset managers. For the rest, Swiss asset managers of collective investment schemes would remain subject to FINMA direct supervision and the CISA provisions currently applicable to them would be directly incorporated in the FAFI without material change.

changes in the limited partners of a Swiss LP are not subject to a notification duty either.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

As a matter of principle and for the time being (see 'Update and trends'), the distribution of interests in Swiss or non-Swiss collective investment schemes in or from Switzerland is subject to obtaining a licence as a 'fund distributor', irrespective of whether such activities target the public or not (however, see the exceptions listed in question 24).

The regulated activity is the 'offering' as such, not the actual investment into a collective investment scheme. As a result, a 'distribution' may take place, even though no Swiss-based investor actually subscribes interests in the collective investment scheme. The requirement to obtain a licence as a fund distributor does not apply to a financial institution already regulated in Switzerland as a fund management company, a bank, a securities dealer, an insurance company or a manager of collective investment schemes.

Against this background, one can distinguish between the offering of interests in a Swiss LP and the offering of interests in non-Swiss investment vehicles, which have not been authorised for distribution to non-qualified investors in Switzerland.

Distribution of interests in a Swiss LP

As a matter of principle, the 'distribution' of interests in a Swiss LP triggers a requirement to obtain a licence from FINMA as a fund distributor.

Distribution of interests in non-Swiss collective investment schemes not authorised for distribution to non-qualified investors in Switzerland

Interests in non-Swiss collective investment schemes, which have not been authorised by FINMA for distribution to non-qualified investors in Switzerland, may only be offered in Switzerland to qualified investors. As a rule, the distribution of such interests to Swiss-based qualified investors is subject to a licensing requirement as a fund distributor under the CISA. As mentioned (see question 24), only limited exceptions are available to the licensing requirements of the distributor. Although the non-Swiss collective investment scheme itself does not need to be approved by FINMA to be offered to qualified investors in Switzerland, the CISA requires that a Swiss representative and a paying agent be appointed for the non-Swiss collective investment scheme. In addition, the foreign distributors are to enter into a written, Swiss law-governed distribution agreement with the Swiss representative, based on the requirements of the SFAMA distribution guidelines and its template distribution agreement (see question 24).

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Swiss anti-money laundering regulatory framework is enshrined in the Anti-Money Laundering Act (AMLA) and its implementing ordinances. The AMLA applies to 'financial intermediaries'. The duties imposed upon financial intermediaries are essentially 'know your customer' (KYC) rules and procedures, as well as certain organisational requirements (for example, internal controls, documentation, continuing education). In addition to these KYC rules and procedures, financial intermediaries must also comply with the duties to report to the regulatory body in the event they have knowledge or suspicion of criminal activity. The reporting duty presupposes that the financial intermediary is aware of or has reasonable suspicion as regards the criminal origin of the assets involved. In this context, the regulatory body is entitled to request information from third-party financial intermediaries that appear to be involved in the transaction or business relationship that triggered the reporting by another financial intermediary.

Further, financial intermediaries must implement a two-step process after the reporting of suspicions to the regulatory body. First, they have to monitor the account in question for a period of up to 20 days during the review of the case by the regulatory body (with the aim of blocking any transaction that may result in preventing or complicating the confiscation of the concerned assets). As a second step, if the case is assigned to a criminal prosecutor, the financial intermediaries have to implement a full freeze on the account for up to five days until a decision to maintain the freeze is made by the criminal authority. An immediate freezing of assets is however required for assets connected to persons whose details were transmitted to the financial intermediary by FINMA, the Federal Gaming Board or a self-regulatory organisation owing to a suspicion of being involved with or supporting terroristic activities. Financial intermediaries may incur a criminal liability should it fail to comply with the above duties.

The Swiss LP falls within the ambit of the definition of a 'financial intermediary' within the meaning of the AMLA. Consequently, the Swiss LP is subject to the duties deriving from the AMLA, in particular the need to identify the investors (namely, the limited partners) and their beneficial owners. From a practical perspective, the information that the Swiss LP requires to comply with its KYC duties is provided on the subscription form and the attachments thereto.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

A Swiss LP cannot be listed on a securities exchange, in particular because the circle of investors in a Swiss LP is limited to qualified investors (see question 24). That being said, as indicated in question 1, shares in a SICAF may be listed.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As indicated in question 29, a Swiss LP cannot be listed on a securities exchange.

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Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

There are no such restrictions. That being said, any investment made by the Swiss LP must comply with the investment restrictions set forth in the partnership agreement.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

See question 21 for an overview of the tax considerations that should be borne in mind when structuring the compensation arrangements.

From a regulatory perspective, it is worth noting that the compensation arrangement for the GP is set forth in the partnership agreement, which means that such arrangement is subject to FINMA's review and approval and is available to the public (see question 4). It should also be noted that, in accordance with the SFAMA Transparency Guidelines, which have been recognised as the minimum standard by FINMA, GPs and LPs have a specific duty to inform investors on fees, costs, rebates and retrocessions. Such information must be disclosed in the fund documentation.

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The two most common legal vehicles in use within the UK for private equity funds are English limited partnerships (ELPs) and Scottish limited partnership (SLPs) formed pursuant to the Limited Partnerships Act 1907 (as amended) (LPA 1907). The ELP and SLP differ in certain key respects including separate legal personality, governing law and place of establishment. While SLPs, because of having separate legal personality, are commonly used vehicles for fund of funds, carried interest and feeder funds, ELPs are the predominant UK private investment fund vehicle. Accordingly, this chapter focuses on ELPs.

An ELP is a partnership registered in accordance with the LPA 1907 and is subject to English partnership law, which includes the Partnership Act 1890 (PA 1890) and the rules of equity and English common law applicable to ordinary (general) partnerships (to the extent not modified to the contrary by an agreement between the partners). An ELP must have at least one general partner (GP) and one limited partner (LP). As a result of recent amendments to the Companies and Partnerships (Accounts and Audit) Regulations, to avoid being a 'qualifying partnership' for the purpose of these regulations and being subject to the requirement to file accounts with Companies House in the same way companies do under such regulations, it is becoming more common to see ELPs with a second, non-corporate GP, such as a limited liability partnership.

An ELP, unlike an SLP, does not possess separate legal personality and is not an incorporated entity or a 'body corporate'. The ELP is thus incapable of contracting in its own name or holding property in its own right. Instead, legal title to the property of an ELP is held on trust by its GP or a nominee company. The GP is responsible for managing the business of the ELP and contracts on behalf of the ELP. The GP may be a natural or corporate person. An LP's liability for the debts and obligations of the ELP is limited to the amount of the capital it contributes to the ELP, whereas the GP's liability for the debts and obligations of the ELP is unlimited. Accordingly, UK GPs of ELPs are typically corporate vehicles that shield their members from liability to third parties.

In March 2016, HM Treasury published its response (the Response) to comments received on its July 2015 consultation paper (the Consultation) and draft Legislative Reform Order (LRO), which seeks to modernise the limited partnership regime though the establishment of a new process and regime enabling a limited partnership to be designated as a private fund limited partnership (PFLP) on registration, and the amendments to some of the provisions of the LPA 1907 and the Partnership Act 1890 as they apply to PFLPs and to partners in PFLPs. See questions 2 and 5 for further detail on the LRO and its positive impact on ELPs.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

An ELP is a partnership vehicle registered in accordance with the LPA 1907 and is formed between two or more persons, at a minimum the GP and a single LP, who agree to carry on a business in common with a view to achieving a profit.

There is no prescribed form that an agreement of limited partnership must take nor is there a requirement for the document to be filed at Companies House. Indeed, there is no requirement for a limited partnership agreement (an LPA) to be written down; an LPA can be a verbal contract. However, given that the LPA 1907 and PA 1890 each contain default provisions which, in the absence of an agreement between the partners to the contrary, will be deemed to govern their relationship, the vast majority of commercial ELPs are governed by prescriptive, documented LPAs that contain contractually agreed terms between the relevant parties.

An ELP must be registered at Companies House using an application for registration of a limited partnership on Form LP5 to obtain the limited liability status conferred by the LPA 1907. The application for registration mandates that certain information be provided, including a description of the general nature of the business, the name of the partnership, the principal place of business of the partnership, the full name of each of the general and limited partners, the amount of the capital contributed by each limited partner as capital to the partnership and the form of contribution (ie, whether it is paid in cash or otherwise), the partnership's proposed term, (if any), the date of the ELP's commencement and a statement that the partnership is an ELP (and thus the liability of its LPs is limited). Form LP5 needs to be signed (or otherwise authenticated) by or on behalf of each of the general and initial limited partners and dated. The form along with a registration fee of (as at the date of publication) £20 or £100 (where same day registration is required), is to be sent to the Registrar of Companies (the Registrar) for the part of the UK in which the principal place of the ELP's business is to be situated (ie, England or Wales). Where any changes to the information supplied via Form LP5 arise, the ELP must provide the Register with a statement on Form LP6 specifying the nature of the changes within seven days of the changes occurring. There is no cost associated with notifying the Register of such a change; however, failure to notify will result in the GP being liable to a daily default fine of (as at the date of publication) £1 for the duration of the default. There is also an obligation to advertise in the London Gazette (the Gazette) when an LP becomes a GP or an LP assigns its interest in the ELP. These changes will only become effective once the advertisement has been made.

Once an ELP is registered, the Registrar will issue a certificate of registration. This certificate includes the ELP's name and registration number and represents conclusive evidence that the ELP came into existence on the date of registration. A register of ELPs is maintained by the Registrar.

The draft LRO includes proposals to simplify the ELP registration process. The Response has confirmed the proposal to abolish the requirement to advertise changes in the GP or LP composition (except for the case of a GP becoming an LP where the requirement remains) with the Gazette, remove the requirement to make and register

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capital contributions and remove the requirement to register the general nature of and term of the PFLP.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

An ELP must have a principal place of business in England or Wales at the time of its initial registration under the LPA 1907. This is usually achieved by having a UK-based GP. Following initial registration there appears to be no obligation on the ELP to maintain a connection with the UK or conduct business in the UK. Consequently, a number of ELPs retire their initial, English GP and have foreign GPs. The Financial Conduct Authority (FCA) confirmed that an ELP's principal place of business is regarded as the equivalent of a registered office when determining whether an ELP is established in the UK for the purposes of Directive 2011/6/EU on Alternative Investment Fund Managers (the AIFMD).

The LPA 1907 does not expressly require ELPs to prepare accounts and the obligations on the partners contained in the PA 1890 to render true accounts and full information on all things affecting the partnership to any partner are subject to any agreement between the partners to the contrary. Typically, the form and contents of the ELPs' financial statements are provided for in the LPA. Unless the ELP is a 'qualifying partnership' under the Companies and Partnerships (Accounts and Audit) Regulations 2013 (the Accounts Regulations) the ELP is not required to file a copy of its accounts with Companies House. Subject to any contrary agreement between the partners, the PA 1890 requires the books of the partnership to be kept at the partnership's place of business or at its principal place of business if it has more than one.

An ELP is not required to appoint a local secretary, or local service providers such as an administrator or custodian unless the ELP is an 'alternative investment fund' (an AIF) as defined under the AIFMD, and its 'alternative investment fund manager' (AIFM) as defined under and for the purposes of the AIFMD is an EU full scope AIFM, in which case its AIFM is required to be authorised under the AIFMD and comply with all substantive requirements under the AIFMD including the requirement to ensure that the ELP appoints an independent depositary (from a list of permissible types of firms or institutions) who shall be established in the same European Economic Area (EEA) member state as the EEA AIF (although until 22 July 2017, regulators have the discretion to allow such depositary to be established in another EEA member state). The AIFMD depositary shall perform specific functions and shall have certain responsibilities pursuant to the AIFMD. A 'depo-lite' may also be required by regulators in certain EEA member states (such as Germany and Denmark) when a non-EEA AIFM registers in such EEA member states for marketing purposes under article 42 AIFMD.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Members of the public can access and request copies of information filed with the Registrar including Forms LP5 and LP6. Changes to the partner composition of an ELP must be notified to the Registrar, although this is expected to be removed by the LRO (see question 2 for further information). An ELP that qualifies as an AIF and is managed by an EEA AIFM or marketed in the EEA by a non-EEA AIFM will be subject to certain reporting to the relevant regulator (the EEA regulator where the EEA AIFM is authorised or in the case of a non-EEA AIFM, where a non-EEA AIFM is registered for marketing purposes). Although information filed with the FCA for authorisation and registration purposes must generally be kept confidential (subject to limited statutory exceptions), certain EEA regulators may give access to certain information filed for registration purposes.

With effect from 1 January 2016 UK 'financial institutions' (as defined for the purposes of the OECD's Common Reporting Standard (CRS) and so including many ELP fund vehicles) are required to undertake due diligence on their investors and account holders and, from January 2017, to report such information to the UK tax authorities (HMRC). The information will then be exchanged with tax authorities in other countries and will enable the UK to meet its obligations under bilateral information exchange agreements that implement the CRS. Implementation of the CRS has also occurred in a number of other jurisdictions, although the US has not yet implemented the rules.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

The LPA 1907 provides that an LP who takes part in the management of the business of an ELP will lose its limited liability and will become liable for the debts of the partnership during the period of their involvement as a GP. An LP may at any time, without forfeiting its limited liability, inspect the ELP's books and may examine the state of the business and may 'advise with' other partners on such matters. In contrast to limited partnership legislation in other jurisdictions such as Jersey and Guernsey, the LPA 1907 does not specify which activities will not constitute an LP's participation in the management of the business of the limited partnership. Care needs to be taken when considering the LP's rights under the LPA and participation by LPs in advisory committees to ensure that the LP does not fall within the scope of 'management', especially in the context of LPs having a representative on an ELP's advisory committee. LPs will typically ask the GP's legal counsel to provide a legal opinion stating that the LP's participation as an LP pursuant to the applicable LPA and (as the case may be) its representative participation as a member of the advisory committee will not endanger such LP's limited liability. The LRO helpfully contains a non-exhaustive 'white list' of activities that an LP in a PFLP may undertake without being considered to take part in the management of the business and therefore without losing its limited liability, such as taking part in:

- investment decisions of the partnership, including decisions regarding partnership borrowings;
- decisions about a change in the partnership business;
- approving partnership accounts or valuations of partnership assets; and
- taking part in decisions about whether a person should become, or cease to be, a partner.

The Response provides that the white list will be drafted to reflect the fact that the list is not exhaustive and that the creation of the white list does not mean that the activities on the list are permissible for limited partners by right.

In contrast to the limited partnership legislation of other typical fund formation jurisdictions such as Jersey and the Cayman Islands, the LPA 1907 does not permit a partner to draw out or have its capital returned to it during the lifetime of the limited partnership. A partner that draws out or receives back a part of its capital shall be liable for the debts and obligations of the limited partnership up to the amount so drawn out or received back. The effect of this provision is that the partner potentially remains liable to re-contribute to the partnership an amount up to the amount of the capital withdrawn. Clearly, this prohibition on returning capital to partners during the life of an ELP is impractical in the context of a private equity fund. The fund needs to be able to distribute the proceeds of investments. Consequently, a partner's commitment to an ELP is typically structured such that amounts contributed by partners are separately classified as an initial capital contribution (typically a nominal sum) made upon admission to the ELP (which will not be returned until the ELP is dissolved), with the remainder of a partner's commitment being structured as an advance or 'loan' to the ELP, which is subsequently drawn down by the GP as and when needed to fund investments and partnership expenses and is repaid to the partners from the proceeds generated by investments. This split of a partner's commitment into capital and loan advances represents an idiosyncrasy unique to UK partnership law. The Consultation recognises that this restriction on the return of a partner's capital contribution creates unnecessary complexity and impracticality in the context of private equity fund structuring. The Response confirms the proposal to remove the requirement for limited partners of a PFLP to make a

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capital contribution, though the option will remain (for example, there may be tax or regulatory advantages in other jurisdictions). Capital that is contributed to a PFLP will be withdrawable and there will be no requirement to declare capital contributions to the Registrar. Where a limited partnership was formed before the implementation of the LRO, capital contributed before redesignation as a PFLP will be treated as under the former regime; capital contributed after the limited partnership is redesignated will then be treated in accordance with the new regime.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

The concept that every partner in a partnership owes a duty of good faith is a cornerstone of the English law on partnerships and applies equally to partners in an ELP as to partners in an ordinary partnership. Subject to any agreement to the contrary, a non-partner manager of an ELP who exercises discretionary management functions will also owe fiduciary duties to the partners of the ELP.

The courts have found that in addition to any specific contractual obligations owed, there is an overarching duty to act in good faith and to act in a fair and honest manner with your partners. GPs are under an obligation to act in the best interests of the ELP; where a GP has not obtained the prior permission of its partners, it must account for any benefit derived from an transaction involving the partnership and must not act in a manner which is contrary to the best interests of the partnership including obtaining a secret profit of personal advantage or allowing its interests to conflict with duties owed to his or her partners.

The scope of certain fiduciary duties may be modified or potentially even excluded under English law. It is unclear, however, whether fiduciary duties can be completely excluded under English law. Such a limitation or exclusion must be within the limits imposed under the common law and under relevant legislation. In any event, it is likely to be commercially unacceptable to LPs for a GP to attempt to exclude fiduciary duties. Certain duties, such as the duty to act honestly and in good faith, are considered inherent within English partnership law. Moreover, it is not possible under English law to exclude liability for deliberate breach of fiduciary duty, fraud or bad faith.

The GP of an internally managed ELP or the external AIFM of an ELP, who is authorised in an EEA member state as an AIFM will also have to comply with the specific duties applicable to it under the AIFMD, including the duty to act honestly, with due skill, care and diligence and fairly, the duty to act in the best interests of the AIF or the investors of the AIF they manage and the integrity of the market, the duty to employ effectively the resources and procedures that are necessary for the proper performance of their business activities, the duties to treat all AIF investors fairly, disclose preferential treatments and take all reasonable steps to avoid conflicts of interest.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Under English law there is no recognised concept of 'gross negligence' as distinct from 'ordinary negligence'. The concept typically arises in contractual drafting whereby the GP will seek to limit or exclude liability to the partnership for losses arising as a result of the GP's ordinary negligence and LPs will seek to ensure that the indemnity granted to the GP, any fund manager or any of their respective affiliates for losses or damages caused as a result of their actions does not extend to gross negligence. Gross negligence implies a level of severity greater than ordinary negligence and modern case law indicates that, where a contract expressly refers to gross negligence, the courts of England and Wales will typically seek to understand the parties' intention behind the use of the term gross negligence as distinct from ordinary negligence. The term is a matter of interpretation and its meaning will depend, each time, on the wording and context of the contract as a whole. The courts have thus far not provided a definitive determination of the concept of gross negligence under contract law as distinct from negligence, however, it has previously been found that gross negligence is clearly intended to represent something more fundamental than failure to exercise proper skill. Certain practitioners have sought to include a specific definition of gross negligence within certain contractual documentation governed by English law or have sought to define the concept by reference to the meaning given under the law of a foreign jurisdiction, such as the law of the state of Delaware.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

The legislation underpinning ELPs (the LPA 1907 and the PA 1890) does not provide for the conversion of a foreign fund into an ELP. Practically, such conversion would have to be effected by the creation of a new ELP and the transfer or contribution of assets from the existing foreign fund to the GP of the ELP or a nominee, in each case to hold on trust for the ELP given the ELP's absence of separate legal personality. The vast majority of terms governing an ELP can be determined contractually by the parties through a documented and prescriptive LPA. Given the limited statutory application to ELPs, an ELP can be established on substantially the same terms as those applying to foreign limited partnerships.

Notwithstanding the above, there are certain idiosyncrasies in the LPA 1907 that are not found in equivalent foreign limited partnership legislation. Such quirks will need to be accommodated in the LPA of an ELP. For instance, as noted above, the prohibition on returning capital to partners during the life of an ELP contained in the LPA 1907 leads to the bifurcation of a partner's commitment to an ELP into a small, nominal capital contribution and a much larger 'loan' that is advanced to the partnership. Secondly, for certain tax purposes ELPs are typically structured so that the GP receives a 'priority profit share' that is then 'on-paid' to the fund manager, rather than the fund manager receiving a management fee from the ELP. See question 23 for further information.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Under the LPA 1907, the death or bankruptcy of an LP will not cause the automatic dissolution of an ELP. Insolvency or winding-up provisions are commonly included in the LPA to provide for an orderly dissolution of an ELP. If the GP becomes insolvent, many LPAs give LPs the ability to appoint a new GP or terminate the ELP. Given that GPs have unlimited liability for the debts of an ELP under LPA 1907, ELPs are typically structured so that the GP is a corporate vehicle with limited liability and the fund manager is a separate entity affiliated with the GP, so as to prevent the fund manager being held liable for the debts of the ELP.

A fund manager based in the UK that provides portfolio and risk management functions to funds qualifying as AIFs, is required to be authorised by the Financial Conduct Authority (the FCA) as an AIFM pursuant to the AIFMD. A UK asset manager who is not acting as an AIFM of the ELP but provides advisory, management or other regulated services as a sub-adviser or delegate of the AIFM or operates individual managed accounts will be required to be authorised by the FCA under the Markets in Financial Instruments Directive (MiFID).

Such authorised UK AIFMs and asset managers will also be subject to the UK statutory regime for change in control of UK authorised

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firms, which is set out in Part XII of the Financial Services and Markets Act 2000 (FSMA) and supplemented by FCA change in control rules. These requirements require any person seeking to acquire 'control' in a UK authorised AIFM or asset manager to obtain the prior consent of the FCA before doing so. Failure to obtain the FCA's consent is a criminal offence. 'Control' for these purposes broadly encompasses any acquisition of 10 per cent of shares or voting power, or significant influence over the management of the AIFM or asset manager (the threshold may be 20 per cent for some AIFMs, depending on the type of licence). The application process requires the submission of detailed information and can take two to six months. A change of control may also likely qualify as a material change to the conditions for initial authorisation of a UK AIFM and require a specific notification with the FCA.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

ELPs are not in and of themselves regulated entities. Instead, the focus of UK fund regulation is on the fund manager. As noted in question 9, UK-based fund managers that provide portfolio and risk management functions to AIFs are required to be authorised by the FCA as AIFMs. The AIFMD imposes substantive regulatory obligations on AIFMs, including rules relating to internal capital adequacy requirements, regulatory and investor reporting, ensuring that each AIF it manages appoints a depositary and restrictions on remuneration of employees of the AIFM, among others. As FCA authorised and regulated entities, UK AIFMs are subject to the FCA's conduct of business rules and general FCA principles of business, including the requirement to deal with the FCA in an open and cooperative manner.

There is a lighter AIFMD regulatory regime for sub-threshold AIFMs, meaning AIFMs that manage portfolios of AIFs which, in aggregate, do not exceed €100 million or, in the case of AIFs that are unleveraged and have no redemption rights exercisable within the first five years of the AIF (ie, typical private equity funds), €500 million. To the extent an AIFM manages assets on behalf of AIFs that combine both these types of AIF, the aggregate threshold of €100 million should be applied when determining whether an AIFM can be classified as a sub-threshold AIFM. While sub-threshold AIFMs do benefit from a lighter touch regulatory regime under the AIFMD, they are not able to take advantage of the AIFMD marketing passport, meaning that they have to comply with the individual national private placement regime (NPPRs) of each EEA member state. NPPRs are not uniformed across the EEA member states and are particularly onerous in some of them. For this reason, many sub-threshold AIFMs have decided to 'opt up' to full-scope AIFM status.

AIFMs that operate individual managed accounts and provide related services such as investment advice will need additional permissions from the FCA for these activities and are subject to additional regulatory requirements (derived from MiFID) in connection with these activities.

The FCA relies heavily on authorised firms to provide information to it but reserves the right to visit, inspect and evaluate the compliance of authorised firms, typically through thematic reviews (which focus on specific industries, for instance, asset management or retail banking), or as part of its general supervisory remit. The FCA is also able to take action at a firm-specific level where it has specific concerns about a particular regulated entity. Some larger or higher risk firms (or both) are also proactively supervised by the FCA on a 'relationship managed' basis.

While the FCA is the primary regulator of UK-based fund managers, other regulators such as the Prudential Regulation Authority (PRA) may have regulatory oversight of certain large investment firms that pose prudential risks to the economy. AIFMs that are part of the same group as these entities or banks may be subject to prudential supervision on a consolidated basis by the PRA.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

An FCA authorised AIFM must notify the FCA of its intention to market an ELP to investors domiciled or with a registered office in the UK. If such AIFM wishes to market an ELP on a cross-border basis into other EEA member states under the AIFMD marketing passport, the AIFM must notify the competent authority of the EEA member states into which the AIFM wishes to 'passport' the ELP and the FCA will in turn transmit this information to the competent authorities of the relevant EEA member states. The AIFMD marketing passport is not available to FCA authorised AIFMs that manage AIFs that are not registered in an EEA member state (for instance, a Cayman exempted limited partnership). In this circumstance, the FCA authorised AIFM will need to comply with each relevant EEA member state's national private placement regime (where available) in the same way that an AIFM not based in an EEA member state would be required to.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

UK-based entities providing portfolio and risk management to AIFs are required to be authorised and regulated by the FCA as AIFMs (see question 10). Authorisation as an AIFM incorporates permission for the provision of investment advice in connection with the AIFs for which the manager carries on portfolio and risk management functions. Provision of investment advice in connection with investments other than AIFs managed by the AIFM is a separate regulated activity, as is the management of individual portfolio accounts. Entities carrying on portfolio management, providing investment advice in relation to investments other than AIFs managed by them, or arranging deals in investments (including funds) other than in connection with AIFs, must be authorised by the FCA to provide these services and regulated by the FCA on an ongoing basis, in compliance with the rules applicable under MiFID.

The process for becoming authorised by the FCA, either as an AIFM or an asset manager, is a lengthy and resource-intensive exercise. FCA authorised entities are subject to a significant volume of rules, including the FCA Principles for Businesses and the FCA's Conduct of Business rules. The FCA requires that persons proposing to carry out controlled functions on behalf of an FCA authorised firm have to be 'fit' and 'proper' to carry out such functions. Such functions include acting as a chief executive, director or partner, money laundering reporting officer and chief compliance officer of an FCA authorised firm. Such persons must be approved by the FCA to perform the controlled functions in question and are subject on an ongoing basis to the FCA's Code of Conduct for Approved Persons and the Statement of Principles for Approved Persons. The FCA needs to be satisfied that persons proposing to carry out controlled functions on behalf of an FCA authorised firm have adequate knowledge and experience to carry out such functions. In recent years, the FCA has placed special emphasis on the integrity and honesty of persons carrying out controlled functions within the financial services industry, in a bid to improve the culture of regulated firms generally. This has resulted in the implementation of new rules for senior management and other key staff within banks and it is anticipated that similar reforms will be implemented for AIFMs and other investment firms from 2018.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

See questions 10 and 12.

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14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no UK rules or regulations (other than rules applicable generally in the UK in relation to political donations, (as well as general UK anti-bribery laws)) that oblige a private equity fund's manager or investment adviser to disclose political contributions made by it.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

There are no UK rules that restrict or oblige a private equity fund's manager or investment adviser to disclose the engagement of placement agents, lobbyists or other intermediaries in the marketing of a private equity fund to public pension plans and other governmental entities, although the FCA may require details of placement agents and marketing activity as part of its supervisory remit. In addition, where an AIFM seeks to market an AIF to UK investors, the FCA's notification form for this purpose requires disclosure to the FCA of the identity of any placement agents engaged to market the fund to UK investors. In addition, article 23 AIFMD requires EEA authorised AIFMs or non-EEA AIFMs marketing to EEA investors to disclose certain information prior to closing, including the identity of service providers, which may include an appointed placement agent. Such disclosures are typically included in the private placement memorandum. Even when these requirements do not apply, the fact that a placement agent has been engaged (and the placement agent's identity) is usually disclosed in the private placement memorandum of the relevant fund or separately disclosed to investors in responses to due diligence questionnaires. These more detailed responses increasingly include detailed disclosure of the basis on which the placement agent or lobbyist is remunerated.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

Since the financial crisis there have been a high number of legal and regulatory developments that may directly or indirectly affect banks' ability or appetite for sponsoring or investing in private equity funds. The EU prudential framework under the Capital Requirements Directive and Capital Requirements Regulation (CRD IV) contains capital and liquidity requirements associated with fund investments, which are potentially of direct relevance.

CRD IV, the fourth iteration of the EU's prudential framework rules, was adopted in July 2013 and has applied since January 2014. CRD IV aims to implement Basel III within the EU, as well as EU-specific reforms on remuneration and governance. The rules under CRD IV governing capital treatment of private equity investments are highly complex and depend upon (among others) the extent of the bank's participation in a particular fund and in funds generally, as well as the type of fund. The starting position is that private equity investments must be deducted from capital, although this is subject to some limitations and more favourable capital treatment may in some cases be available for certain venture capital investments above certain participation thresholds. Private equity investments that are not deducted from capital must generally be risk weighted at 150 per cent under the 'Standardised Approach' (for less sophisticated banks) or at 370 per cent or (for sufficiently diversified funds) 190 per cent under the 'Internal Ratings Based' approach (for more sophisticated banks). Recent proposals from the EU authorities published in November 2016 indicate that the future capital treatment of risk-weighted fund investments will depend increasingly on the types of underlying fund investments and the level of transparency for banks on the underlying investments.

CRD IV also introduced quantitative requirements on liquidity, which will impose a liquidity cost on banks' holdings in funds for which commitments may be called within 30 days or less. Future changes to CRD IV will also result in the implementation of quantitative requirements on leverage and stable funding (anticipated to become effective from 2019), which may also result in increased costs associated with private equity investments.

A further issue for banks and the funds in which they invest is the potential for banks' liabilities (which could include liabilities to funds) to be 'bailed in' in the event that the bank becomes subject to a statutory resolution process under the Bank Recovery and Resolution Directive (BRRD). This may include the write down or conversion into equity of banks' unsecured liabilities. Article 55 of the BRRD requires that liabilities within the scope of the BRRD's bail-in powers, but governed by the law of a third country, include a contractual term stating that the liability may be subject to write-down and conversion powers of the relevant resolution authority (in this case the Bank of England). Carveouts may apply, however, for some liabilities where certain criteria (including impracticability) are met.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

A private equity fund formed as an ELP should not normally be treated as a separate taxable entity for UK tax purposes. There should therefore be no UK withholding taxes on distributions to investors and the ELP should not be subject to UK tax on income and gains from its investments. Instead, for UK tax purposes, investors in the fund should be regarded as holding their proportionate share of the fund's income and gains as determined in accordance with the fund's profit sharing arrangements. UK taxable investors will be subject to UK tax on their allocations from the fund in accordance with their personal tax positions.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Generally speaking, the investment strategy of most private equity funds is such that they should be regarded as carrying on an investment business rather than trading for UK tax purposes (though the strategy of some funds is less clear in this regard). Provided the fund is regarded as investing rather than trading for UK tax purposes non-UK resident investors should not be subject to UK tax on their proportionate share of income and gains of the fund unless the non-UK resident investor holds its interest in the fund in connection with or for the purposes of a trade carried on by it in the UK through a UK branch, agency or permanent establishment. The UK government is, however, consulting on bringing within the scope of UK tax gains realised by non-residents on the disposal of real property, including commercial property. The government's response to the consultation is due to be published in late summer 2018 for measures to take effect from April 2019; developments in this regard should be monitored. Otherwise, a non-UK resident investor should only be subject to UK tax in respect of its participation in the fund to the extent of any UK tax deducted at source from UK source income (such as interest), if any, received by the fund. Investors resident outside the UK may be entitled, with regard to UK tax deducted from their apportioned share of any UK source income,

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to the benefit of any double taxation agreement between their country of residence and the UK.

The fund may be required to file a UK partnership tax return and non-UK resident investors will be required to provide basic details to the fund and register with the UK tax authorities in order to comply with any such requirement. Some simplification is expected in this regard for returns made after Finance Bill 2018 receives royal assent, including that partners need not provide a UK tax reference if they are not chargeable to UK tax in the relevant period, the partnership did not carry on a trade, profession or UK property business in the relevant period and the whole of the relevant period is one in which the partnership is required to report information about the partner under certain international information reporting regimes. The Finance Bill 2018 will also include legislation intended to clarify certain other aspects of partnership taxation, including legislation dealing with the situation where partnerships have partners which are themselves partnerships.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

It is not typical for private equity funds or their participants to obtain rulings from HMRC in relation to their treatment. There are no special rules applicable to investors in a UK private equity fund. However, it should be noted (as discussed in question 21) that the UK government has introduced rules specifically focused on the taxation of carried interest holders and those who perform investment management services for the fund.

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no such organisational taxes payable by ELPs.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Carried interest arrangements for UK private equity sponsors have typically been structured using a carry limited partnership (referred to as the Carry LP, often an SLP), which is admitted as an ELP partner. Each participant's share of carried interest is delivered through an interest in the Carry LP. Accordingly, historically, subject to points in relation to the taxation of employees mentioned below, the UK taxation of participants in the Carry LP generally followed that which would apply to any other UK-resident investor in the fund. The carry participants' share of the fund's income and gains would be subject to UK income or capital gains tax according to the nature and character of the carried interest receipt (ie, whether it represented income – such as dividends or interest – or capital gains from investment realisations) and the individuals' personal circumstances. However, the UK tax landscape applicable to private equity fund executives has changed significantly in recent years.

In April 2015, the UK government introduced the disguised investment management fee rules which, broadly speaking, charge to tax as income everything arising to an individual who is providing investment management services in the UK to a collective investment scheme unless the amounts fall within legislative exemptions for carried interest or genuine arm's-length co-investment. These changes were focused on structures designed to 'stream' part of what was in effect the regular management fee from the fund to the management team so that it was received by individuals as a profit share from the underlying fund (and so potentially subject to capital gains tax – the highest marginal rate of which applicable to carried interest is currently 28 per cent – as opposed to income tax – the highest marginal rate of which is currently 45 per cent). The rules are intended to ensure that 'management fee' type remuneration received by fund managers, in whatever form, should be subject to income taxation.

For those elements of remuneration that remain subject to capital gains tax (see above) additional rules were introduced in July 2015 to remove the benefit of 'base-cost shift'. This was an arrangement by which UK-resident recipients of carried interest could, broadly, reduce the amount of their taxable capital gains by reference to costs borne economically by other investors. Furthermore, for non-domiciled UK tax residents the chargeable gain will now be treated as UK source to the extent the individual performs his or her investment management services for the relevant fund in the UK, meaning that, to the extent of their UK activities for that fund, such persons may be subject to capital gains tax on carried interest whether or not remitted to the UK.

Additionally, in April 2016 the UK government introduced legislation (the 'income-based carried interest' rules) to restrict the capital gains tax treatment of carried interest and other performance linked rewards received by UK residents and other individuals performing investment management services in the UK through a UK permanent establishment. This reflects a policy objective that capital gains tax treatment should be restricted to performance-linked rewards arising from long-term investment activity only. Under the new rules carried interest arising on or after April 2016 can only be fully eligible for capital gains tax treatment (where such treatment would otherwise be available) if the average weighted holding period (AWHP) of the investments by reference to which the carry is calculated exceeds 40 months. If the AWHP does not exceed 36 months, all of the carried interest will be treated as 'income based carried interest' (subject to income tax and self-employed individuals' national insurance contributions). If the AWHP is between 36 and 40 months, a graded scale of eligibility for capital gains tax treatment will apply. Complex rules apply the AWHP test differently in certain circumstances, including in relation to direct lending funds, funds that invest in controlling and significant stakes of unquoted trading businesses, venture capital and real estate funds and in respect of carried interest arising in the early years of the fund.

Carry participants who are employees (or members of a UK limited liability partnership (LLP) who are regarded as employees for UK tax purposes) are generally subject to the UK's 'employment related securities' regime in respect of their carried interest. Under these rules, charges to UK income tax and national insurance contributions can arise if the amount paid for the carried interest is less than its 'unrestricted market value' at the time of its acquisition (ie, ignoring restrictions placed on the interest). The British Private Equity and Venture Capital Association and HMRC have, however, agreed a memorandum of understanding (MOU) with respect to the application of these rules to carried interest. If the carried interest arrangements relating to the fund are consistent with those in the MOU, HMRC will accept that the unrestricted market value of the carried interest acquired by an employed participant is equal to the amount actually paid for such interest (often nominal), assuming the interest is acquired on formation of the fund. Such participants should not then be subject to employment income taxation on the acquisition of the carried interest or in respect of their returns. Where, owing to the particular carry arrangements, the MOU is not thought to provide sufficient comfort, participants can also make a joint tax election with their employer (known as a section 431 election) the broad effect of which is to ensure future carry returns should not be subject to employment income taxation. Employed carried interest participants are outside the current scope of the draft income based carried interest rules discussed above.

Those involved in the structuring of fund sponsor incentives should also be alive to the two partnership anti-avoidance regimes introduced by the UK government in 2014, namely the LLP 'salaried member rules' and the legislation concerning the allocation of profits and losses in partnerships with mixed individual and non-individual members.

One other recent consideration for some UK general partners relates to the fact that they are often loss-making in the early years of a fund when their management fee expense exceeds the income generated through their profit share. Those losses have traditionally been useful in sheltering tax in later years when the profit share from the fund exceeds management fees. However, under rules having effect from April 2017, there is a restriction on the set-off of carried-forward losses, permitting them only to be set against 50 per cent of total profits exceeding an annual allowance of £5 million.

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22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

In relation to the fund itself, an ELP is not typically able to rely on UK tax treaties as it is not a taxable entity for UK tax purposes. The UK does, however, have an extensive network of tax treaties with various jurisdictions that may be relevant in relation to downstream investment structuring including in relation to assets that generate UK source income. The availability of treaty relief for entities owned by investment funds should, however, be considered in light of the proposed amendments to double tax treaties discussed in question 23.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

Typically, in the UK, private equity funds do not qualify as special investment funds, the management of which is exempt from VAT. Investment management (and, if applicable, advisory) fees may therefore be chargeable to UK VAT (at 20 per cent). However, (as discussed above) ELPs are generally structured so that the GP receives a priority profit share (not subject to VAT on first principles) rather than a management fee, with a separate investment manager receiving a management or advisory fee that is paid out of the GP's profit share. The ELP is typically then organised with a GP in an 'offshore' jurisdiction (such as Delaware or Jersey) so that such fee may be paid outside the scope of VAT or, alternatively, the UK fund manager and its UK subsidiary (acting as the GP of the fund) form a VAT group with the result that there is no supply between those entities for VAT purposes. Where the 'offshore' GP route is followed, it is of course necessary to maintain sufficient substance in the chosen jurisdiction and to consider the GP structure in light of the Accounts Regulations (see question 3).

In certain circumstances, a written instrument of transfer relating to an interest in an ELP may be subject to UK stamp duty where the interest is being transferred by way of sale. The amount of stamp duty payable should be limited to 0.5 per cent of the market value of any stock or marketable securities held by the fund.

Readers may be aware that the global tax landscape is in a state of change in light of the OECD's Base Erosion and Profit Shifting (BEPS) project. The UK government has already implemented UK laws designed to address certain practices that form the subject of the project (such as the 'diverted profits tax', the 'hybrid mismatch' rules and a limit on corporate interest expense deductions). In November 2016, the OECD also published a multilateral instrument designed to enable all OECD countries to meet the treaty-related minimum standards that were agreed as part of the final BEPS package, including changes to the manner in which the entitlement to benefit from double tax treaties is determined and permanent establishments are recognised. The multilateral instrument has now been signed by at least 70 countries. It will be important to consider the MLI and other BEPS related legal changes in relation to both fund and downstream investment structuring and management.

Also of note for funds investing in the UK are some changes that have been made to the UK's participation exemption for the sale of 'substantial shareholdings' (the SSE). The changes include relaxation of the SSE rules where the UK entity making the disposal is owned (directly or indirectly) by 'qualifying institutional investors' (including pension schemes, sovereign wealth funds and certain UK authorised and retail funds).

A further tax-related law in the UK that funds and their portfolio companies need to be aware of and react to is the introduction from the end of September 2017 of new criminal offences for failure to prevent the criminal facilitation of tax evasion. The new law can expose UK companies and partnerships (and some non-UK companies and partnerships) to unlimited fines, and ancillary orders such as confiscation orders, if their employees, agents and some service providers criminally facilitate UK or non-UK tax evasion while acting in their capacity as employee, agent or service provider. Since the offences are 'strict liability' in nature (ie, they do not require any knowledge or intention), it will be important to ensure that steps are taken to access the defence of having reasonable prevention measures in place.

Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Except for publicly listed funds (see question 29 for more details), private equity funds are typically offered to a limited number of sophisticated, largely institutional investors in the UK by way of private placement.

The term 'marketing' is defined under the AIFMD as 'a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union'. Marketing activities conducted by placement agents are considered to be carried out 'on behalf' of an AIFM and therefore are caught by the AIFMD marketing rules and restrictions.

Given that marketing has to be either 'at the initiative or on behalf of the AIFM', contact initiated by investors should not, by definition, be considered marketing and therefore should not be subject to the AIFMD marketing restrictions. The concept of 'reverse solicitation' is recognised in the AIFMD and by European regulators. However, there is no definition of or specific guidance on this concept at European level and the approaches taken by regulators at member states level differ from jurisdiction to jurisdiction. The FCA applies a narrow concept of marketing and has provided a helpful guidance specifying that a confirmation from the investor that the offering or placement was made at its initiative should normally be sufficient to demonstrate a reverse solicitation, unless it is used to circumvent the application of the AIFMD.

The definition of marketing under the AIFMD also provides for investors being 'offered' units in AIFs. This has given rise to the question of what activities are permissible before an AIFM is deemed to be 'marketing', within the scope of the AIFMD. It would be impractical for AIFMs to have to comply with the AIFMD before they have been able to gauge whether there is any investor appetite for their fund in a particular EEA member state. The concept of 'pre-marketing', like reverse solicitation, is a nebulous concept and each AIFMD regulator takes a differing view. In the UK, for instance, where the concept of marketing is narrow, it is generally permissible for AIFMs to discuss an AIF with investors and distribute pitch books, draft fund documents (such as a draft LPA and draft private placement memorandum) until such fund documents are substantially final without being considered 'marketing' and therefore triggering the application of the AIFMD. However, most other EEA member states have a broader concept of marketing and marketing starts as soon as any type of communication is circulated to potential investors that identifies the fund and its strategy.

It should be noted that the financial promotion rules contained in the FSMA and the Financial Services and Markets Act (Financial Promotions) Order 2005 apply to fund marketing activities. The financial promotions rules are wide in scope and cover communications, in the course of business, of an inducement or invitation to engage in investment activity. The financial promotions rules are separate to the AIFMD. However, an authorised or registered AIFM will be considered as compliant with such rules where it markets an AIF to professional investors in accordance with the AIFMD. Any marketing to retail investors will need to comply with additional domestic restrictions. These rules will therefore apply in situations where an AIFM relies on reverse solicitation and may apply in the context of pre-marketing situations under the AIFMD.

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

There are no UK restrictions on the types of investor that may participate in private equity funds although some investors may be restricted under the terms of their constitution or by capital or liquidity constraints. See question 24 for information on marketing restrictions.

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26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

Upon registration of an ELP at Companies House, certain information, including the full name of each of the general and limited partners and the amount contributed by each LP as capital to the partnership and the form of contribution, must be filed with the Registrar on Form LP5. Where any changes to this information occur, Form LP6 must be filed with the Registrar. There is also an obligation to advertise in the Gazette when an LP transfers its LP interest. This change is only effective once the advertisement has been made. The Response confirmed the proposal to remove the requirement to advertise in the Gazette when a limited partner transfers its LP interest to another person. The government will also disapply section 36 of PA 1890 (rights of persons dealing with firm against apparent members of firm) with respect to PFLPs, as suggested in response to the Consultation. The requirement to advertise a notice in the case of a GP becoming an LP will remain; however, the problematic delaying of the effect of the change until advertisement will be removed. See question 9 for information on when there is a substantial change of control and question 4 for information relating to the CRS.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

As discussed in question 10, under the AIFMD, each AIF has to have an AIFM and UK AIFMs are required to be authorised and regulated by the FCA. Marketing under the AIFMD is an activity that is considered as being an AIFM's function performed by or on behalf of the AIFM and an EEA AIFM that is authorised under the AIFMD to manage and market an AIF (and comply with all substantive requirements under the AIFMD) can then market the EEA AIF in other EEA member states using the AIFMD marketing passport. Non-EEA AIFMs cannot become fully AIFMD authorised and benefit from the AIFMD marketing passport and can only market under NPPRs and need to register individually with the regulator in each EEA member state under article 42 AIFMD before starting marketing in such EEA member states. In addition, the marketing of interests in private equity funds in the UK as intermediary or placement agent may constitute a regulated activity, such as arranging deals in investments. This requires the person offering such interests to have the appropriate regulatory permissions from the FCA. Fund managers should ensure that any placement agent engaged as part of a fundraising effort is appropriately regulated and has the correct regulatory permissions.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

The Fourth Money Laundering Directive (MLD4) updates the existing anti-money laundering regime in force in the UK and is required to be implemented in all member states of the EU, including the UK, by 26 June 2017 at the latest. Corporate and other legal entities, potentially including partnerships established in the UK, will be required to obtain and hold accurate and current information on their beneficial ownership, including on persons that have significant control. Beneficial owners include, broadly, natural persons who ultimately own or control, directly or indirectly, 25 per cent of a legal entity. If it is not possible to identify a beneficial owner and there are no grounds for suspicion of money laundering or terrorist financing, the beneficial owner can be identified with the natural persons who hold the position of senior managing official within the business (ie, the person who exercises control over the management of a legal entity). Legal entities covered by the regime will be obliged to transmit up-to-date information to a central public register located in the UK accessible by regulators and regulated businesses. Information to be held in the central register must be adequate, accurate and current. All firms will be required to maintain a register of beneficial owners available for public inspection at the firm's registered office or specified location.

MLD4 expands the pre-existing requirement on entities to carry out customer due diligence when establishing a business relationship, carrying out occasional transactions amounting to €15,000 or more or the transfer of funds exceeding €1,000. MLD4 will introduce a stricter standard for customer due diligence than is currently in force, as there will no longer be an automatic presumption that entities regulated for money laundering purposes and domiciled in the UK, in member states of the EU or equivalent jurisdictions are deemed to be low risk (and so subject to reduced customer due diligence measures).

Firms are required to maintain adequate records of documents gathered in compliance with customer due diligence obligations for a period of five years following the end of the business relationship or the date of the occasional transaction.

If in the course of business, a fund manager becomes aware or suspects that a customer is engaged in certain activities that are linked to money laundering, it must report this to the UK National Crime Agency. On 5 July 2016, the European Commission also published further proposals for a fifth money laundering directive (MLD5), which aims, among other reforms, to clarify further certain elements of MLD4 (regarding approach to high risk countries, for example), to give enhanced monetary powers to national authorities and to bring virtual currencies within the scope of the regime. The final text of MLD5 has yet to be agreed by EU authorities but it is expected to be adopted in early 2017, with implementation dates to be confirmed.

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Private equity funds are able to list on certain UK securities exchanges, for instance the London Stock Exchange's (the LSE) main market and the LSE's Special Funds Market. Although listing private equity funds is not customary, listing a fund provides a number of advantages to fund managers, such as increased distribution potential (as retail investors can invest in listed funds) and access to 'permanent capital', thus permitting fund managers to invest in long-hold assets (such as infrastructure) without having to sell investments prematurely in order to realise proceeds before the end of the fund's life. The main disadvantage to listing is the increased level of transparency required of listed funds and the increased regulatory burden – fund managers have to file publicly available accounts and comply not just with funds related legislation but also legislation applying to listed companies.

Please note that corporate entities tend to be used as listed private equity fund vehicles rather than ELPs.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

Transfer restrictions are typically included in the constitutional document governing the listed fund vehicle, often alongside forced sale or redemption constructs, or both, primarily to address US securities law considerations. As a general matter, a listing on the LSE (including on the main market or in the specialist fund segment) requires that the securities not be subject to unacceptable restrictions on transfer. The UK Listing Authority has, however, historically permitted tailored restrictions (including, in the case of listed fund vehicles, in their constitutional documents) in order to permit issuers to avoid falling within onerous foreign legislative requirements.

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Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

As noted in question 1, ELPs do not have separate legal personality and therefore cannot hold property in their own right or name. Consequently, legal title to the ELP's property tends to be vested in the name of the GP or a nominee company, with beneficial title vesting in the ELP.

UK-based AIFMs are also subject to the asset stripping rules under the AIFMD. Broadly speaking, the asset stripping rules prohibit capital reductions, certain distributions, share buybacks and redemptions for the first 24 months following the acquisition of control of an EEA portfolio company by an AIF managed by the UK AIFM. In practice, the rules can cause considerable difficulties and will, for instance, prohibit activities such as dividend recapitalisations taking place within the first 24 months of control of the relevant portfolio company. Attention should be paid to the structuring of investments in light of these rules.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Full-scope AIFMs established in the UK have to comply with the FCA's AIFMD Remuneration Code (in the FCA Handbook at SYSC 19B) and the European Securities and Markets Authority's (ESMA) guidelines on sound remuneration policies under the AIFMD, which together impose extensive requirements and restrictions on remuneration policies and procedures, governance, structures and pay-outs. The aim of the rules and guidelines is to promote sound and effective risk management that does not encourage risk taking inconsistent with the risk profile of the AIFM or the AIFs it manages. Certain of the requirements apply firm-wide, while others apply only to staff with a material impact on the risk profile of the AIFM or AIFs. For these purposes, remuneration includes carried interest paid by the AIF itself but the ESMA guidelines contain a safe-harbour enabling certain of the more onerous requirements to be treated as met by an EU-style whole-fund carried interest model where carried interest paid is subject to clawback during the life of the AIF and upon liquidation.

The AIFMD requires AIFMs to comply with the remuneration requirements in a way that is proportionate to their size, internal organisation and the nature, scope and complexity of their activities and FCA guidance interpreting this proportionality principle has enabled many UK-based AIFMs to disapply the AIFMD's most onerous pay-out process rules. AIFMs within banking groups may, in addition, need to apply the remuneration requirements of CRD IV to AIFM staff who have a material impact on the risk profile of the UK consolidation group or on the CRD IV firm within that group. Where there is a conflict between the two sets of rules, the AIFMD rules take priority with the exception of the 'bonus cap', which does not feature in the AIFMD and which would nonetheless apply to the relevant staff member unless disapplication was permissible on grounds of proportionality or because of their level of pay and relative proportion of variable pay under a de minimis rule. It remains to be seen whether legislative proposals to amend CRD IV in 2019 will narrow the scope of the bonus cap.

The European Banking Authority is consulting on a new prudential regime specifically tailored to the needs of investment firms that are not systemic and bank-like and a report and opinion on the new regime is expected at the end of June 2017. This does not specifically address the position of AIFMs but may have an impact for AIFMs that have additional asset management permissions or are part of banking and investment groups, or both. The AIFMD also requires the AIFM to disclose, as part of each fund's annual report, the aggregate amount of remuneration paid by the AIFM, including the amount of carried interest and certain break-downs. The annual report must be made available to the investors and the FCA upon request.

Recent changes to the UK taxation of management fees, carried interest and performance-related returns (as discussed in question 21) should also be considered.

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Formation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

In the United States, private equity funds are typically formed as limited partnerships in the State of Delaware, pursuant to the Delaware Revised Uniform Limited Partnership Act (DRULPA). A limited partnership formed under the DRULPA will have a separate legal personality, the existence of which will continue until cancellation of the limited partnership's certificate of limited partnership. A Delaware limited partnership offers investors the benefits of limited liability as well as flow-through tax treatment in the US. The personal liability of a limited partner is generally limited to the amount of the capital contributed or that has been agreed to be contributed (or returned) by such investor. The 'manager' is the general partner of the fund with control over and, subject to certain limitations, general liability for the obligations of the partnership.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

A limited partnership requires at least one general partner and one limited partner, neither of which needs to be a Delaware entity. To form a limited partnership, the general partner must execute and file a brief certificate of limited partnership setting forth certain basic information about the partnership. In Delaware, this filing is made with the secretary of state's office. Each Delaware limited partnership must have and maintain (and identify in its certificate of limited partnership) a registered office and a registered agent for service of process on the limited partnership in Delaware. The certificate of limited partnership must also identify the name of the partnership and the name and address of the general partners, although the names of the limited partners need not be disclosed. In addition, depending on the US jurisdictions in which the private equity fund conducts its business, it may be required to obtain qualifications or authorisations (as well as comply with certain publication requirements) to do business in such jurisdictions. There is generally no time delay associated with filing the certificate of limited partnership; it can normally be prepared and filed on a same-day basis. The initial written limited partnership agreement to be entered into in connection with the formation of a limited partnership can be a simple form agreement, which can be amended and restated with more detailed terms at a later date. For a limited partnership formed in Delaware, the partnership agreement need not be (and generally is not) publicly filed. The fee for filing a certificate of limited partnership in Delaware is US$200 (although an additional nominal fee may be charged for certified copies of the filing or for expedited processing).

There is an annual franchise tax of US$300. The fees for obtaining authorisation to do business in a particular jurisdiction are usually nominal, but may be more costly in certain states. There are no minimum capital requirements for a Delaware limited partnership.

A private equity fund will typically engage counsel to draft the certificate of limited partnership and the related partnership agreement. Filings in Delaware, as well as in other jurisdictions where an authorisation to do business is required, are typically handled by a professional service provider for a nominal fee (which also provides the registered agent and registered office services referred to above).

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A Delaware limited partnership must have and maintain a registered office and a registered agent for service of process in the state of Delaware. This requirement is typically satisfied by the limited partnership engaging for a nominal fee a professional service provider to act in these capacities (see question 2). Although under the DRULPA a limited partnership must maintain certain basic information and records concerning its business and its partners (and in certain circumstances provide access thereto to its partners), there is no requirement that such documents be kept within the State of Delaware. There is no requirement under Delaware law to maintain a custodian or administrator, although registered investment advisers under the US Investment Advisers Act of 1940, as amended (the Advisers Act) must maintain an independent custodian of client assets.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

Although the DRULPA provides that limited partners are entitled (if they have a proper purpose and subject to such reasonable standards as may be set forth in the partnership agreement or otherwise established by the general partner) to receive a list of the names, addresses and capital commitments of the other partners, a copy of the partnership agreement and any amendments thereto and certain other information, the limited partnership's partnership agreement may limit or expand this. Further, the partnership agreement may, and typically does, provide that any such information provided to limited partners is confidential and is not to be disclosed by a limited partner to third parties. Therefore, the public is not generally entitled to information (other than the identity of general partners, which is set forth in the certificate of limited partnership) about Delaware limited partnerships. Nevertheless, as a result of the US Freedom of Information Act (FOIA), certain similar state public records access laws and other similar laws, certain limited partners who are subject to such laws may be required to disclose certain information in their possession relating to the partnership. Generally, the information that has been released to date pursuant to FOIA and similar laws has typically been 'fund level' information (eg, overall internal rates of return, other aggregate performance information, amounts of contributions and distributions, etc) but not 'portfolio company level' information (eg, information relating to individual investments by the fund). Also, limited partnership

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agreements and the list of limited partners have generally been protected from disclosure to the public. A general partner's failure to comply with the reporting requirements of applicable law or the partnership agreement (or both) could result in a limited partner seeking injunctive or other equitable relief, monetary damages, or both.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

Under Delaware partnership law, a limited partner is not liable for the obligations of a limited partnership unless such limited partner is also a general partner or, in addition to the exercise of the rights and powers of a limited partner, such limited partner participates in the 'control of the business' of the partnership within the meaning of the DRULPA. It is generally possible to permit limited partners to participate in all aspects of the internal governance and decision-making of the partnership without jeopardising the limited liability status of a limited partner, as long as it is done in a prescribed manner. Even if the limited partner does participate in the control of the business within the meaning of the DRULPA, such limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

In addition, under the DRULPA, a limited partner who receives a distribution made by a partnership and who knew at the time of such distribution that the liabilities of the partnership exceeded the fair value of the partnership's assets is liable to the partnership for the amount of such distribution for a period of three years from the date of such distribution, and partnership agreements of private equity funds commonly impose additional obligations to return distributions. There may be additional potential liabilities pursuant to applicable fraudulent conveyance laws. In any case, limited partners are liable for their capital contributions and any other payment obligations set forth in the limited partnership agreement or related agreement (such as a subscription agreement) to which they are a party.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A general partner of a limited partnership generally will owe fiduciary duties to the partnership and its partners under Delaware law, which include the duties of candour, care and loyalty. However, under Delaware law, to the extent that, at law or equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by the provisions in the partnership agreement, provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing. Under Delaware law, a partnership agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a partner or other person to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, provided that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing. In addition, practitioners should note that contractual standards of duty or conduct set forth in the partnership agreement will replace common law fiduciary duties with respect to Delaware limited partnerships (whether such standards are higher or lower); therefore, precise crafting of the language in a partnership agreement with respect to fiduciary duties relating to a Delaware limited partnership is important.

In addition, investment advisers (whether or not registered) owe fiduciary duties to their clients. Such fiduciary duties are not specifically set forth in the Advisers Act or established by rules promulgated by the SEC, but are imposed on investment advisers by operation of law because of the nature of the relationship between the investment advisers and their clients. Such fiduciary duties are enforceable against investment advisers by means of the anti-fraud provisions of section 206 of the Advisers Act.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

Delaware does recognise a 'gross negligence' standard of liability to the extent such standard is provided for in the applicable partnership agreement. As a matter of market practice, the exculpation and indemnification provisions in a private equity fund's limited partnership agreement typically carve out acts or omissions that constitute gross negligence, but under Delaware law, a partnership agreement could expressly exculpate or indemnify for such acts or omissions.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Restrictions on transfers and withdrawals, restrictions on operations generally, provisions regarding fiscal transparency and special investor governance rights on matters such as removal of the general partner or early dissolution of the private equity fund are all matters typically addressed in the provisions of the partnership agreement and will vary from fund to fund. Typically, the partnership agreement will require the consent of the general partner to effect a transfer of a partnership interest in a limited partnership. This requirement enables the general partner to maintain the fund's compliance with applicable legal, tax and regulatory requirements and exemptions, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. Although there is generally no right for a limited partner to withdraw from a Delaware limited partnership under the DRULPA, the limited partnership agreement for a private equity fund may provide for certain withdrawal rights for limited partners, typically only in limited circumstances for legal and regulatory reasons. Limited partners have the right to petition the Delaware Court of Chancery for withdrawal or similar equitable relief in egregious circumstances (eg, fraud); however, obtaining such relief can be difficult.

In converting or redomiciling a limited partnership formed in a non-US jurisdiction into a limited partnership in a US jurisdiction (eg, Delaware), particular attention should be given to requirements of the certificate of limited partnership domestication and certificate of limited partnership that may be required to be filed, as well as any other requirements of the applicable state's laws relating to maintaining a limited partnership in such jurisdiction (see question 2). In addition, depending on where the redomiciled fund conducts its business, it may be required to obtain qualifications or authorisations to do business in certain jurisdictions. Any provisions of the partnership law of the state into which such domestication is effected that are otherwise inconsistent with the pre-existing governing agreement of such partnership should be reviewed and modified as necessary to ensure conformity with the applicable law. Consideration should also be given to the tax consequences of converting or redomiciling a limited partnership.

Certain aspects of US securities laws apply differently with respect to US and non-US private equity funds. For example, in determining whether a private equity fund formed in the US will qualify for exemption from registration under the Investment Company Act of 1940, as amended (the Investment Company Act), all investors, both US and non-US, are analysed for determining the fund's compliance with the criteria for exemption. By contrast, in the case of a private equity fund formed in a jurisdiction outside the US, only US investors are analysed for the purposes of making that same determination (assuming certain other requirements are met).

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The Securities Exchange Act of 1934, as amended (the Exchange Act), and the regulations promulgated thereunder generally require that any issuer having 2,000 or more holders of record (or 500 or more holders who are not 'accredited investors' as defined by the SEC) of any class of equity security and assets in excess of US$10 million register the security under the Exchange Act and comply with the periodic reporting and other requirements of the Exchange Act. These rules have the practical effect of imposing a limit of 1,999 investors in any single US-domiciled private equity fund. In addition, the Exchange Act and the regulations promulgated thereunder provide an exemption from the registration requirement described above for a non-US domiciled private equity fund that qualifies as a 'foreign private issuer' and has fewer than 300 holders of equity securities resident in the US. A private equity fund that is organised outside of the US generally qualifies as a foreign private issuer unless more than 50 per cent of its outstanding voting securities are held by US residents or any of the following is true: a majority of its executive officers and directors are US citizens or residents; more than 50 per cent of its assets are located in the US; or its business is administered principally in the US.

For purposes of generally accepted US accounting principles, to avoid consolidation of the financial statements of a private equity fund with its general partner, which is an issue of particular concern for some publicly listed private equity fund sponsors, the fund must provide its unaffiliated limited partners with the substantive ability to dissolve (liquidate) the fund (and appoint a third party as liquidator) or otherwise remove the general partner without cause on a simple majority basis (often referred to as kick-out rights).

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

Depending on the structure of a private equity fund and its general partner and the specific provisions of their operating agreements, the bankruptcy or insolvency of the ultimate sponsor of a private equity fund could result in the bankruptcy or dissolution of the private equity fund's general partner or investment adviser or of the fund itself. Moreover, such a bankruptcy or insolvency event could result in the inability of the sponsor to meet its funding obligations with respect to its capital commitment to the private equity fund. Depending on the terms of the private equity fund's partnership agreement, such a default could constitute a 'cause' event and thereby trigger rights of the limited partners to remove the private equity fund's general partner, dissolve the private equity fund itself or cause the forfeiture of all or a portion of the general partner's unrealised carried interest, or all of these. In addition to such 'cause' protections, a sponsor bankruptcy may result in a private equity fund's limited partners seeking to exercise the 'no-fault' remedies included in many partnership agreements, which often permit termination of the investment period, removal of the private equity fund's general partner or dissolution of the private equity fund. With respect to US bankruptcy law, a sponsor that has filed for reorganisation under Chapter 11 of the US Bankruptcy Code should still be permitted to operate non-bankrupt subsidiaries (including, for example, related private equity funds and their general partners) as ongoing businesses, although this raises a variety of operational issues including, for example, whether ordinary course investment and private equity fund management decisions must be approved by the bankruptcy court.

A change of control or similar transaction with respect to an institutional sponsor may also give rise to statutory and contractual rights and obligations, including one or both of the following:

- a requirement under the Advisers Act for registered investment advisers to obtain effective 'client' consent (namely, consent of the private equity fund's limited partners or a committee thereof) to transactions involving an 'assignment' of the sponsor's investment advisory contract (which a change of control generally triggers); and
- the ability of the private equity fund's limited partners to cancel the commitment period, dissolve the fund, remove the general partner or sue the general partner for a breach of a negative covenant against transfers of interests in the general partner under the terms of the private equity fund's partnership agreement.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?

Advisers Act registration requirements and exemptions

The SEC has the authority to regulate investment advisers pursuant to the Advisers Act. Investment advisers may also be subject to regulatory requirements at the state level. Under the Advisers Act, all investment advisers to private equity funds are generally required to be registered with the SEC under the Advisers Act unless they meet one of the following limited exemptions from such registration:

- the venture capital fund adviser exemption – investment advisers solely to 'venture capital funds' (private funds that represent themselves to their investors and prospective investors as pursuing a venture capital strategy and comply with other significant requirements, including limitations of the amount of leverage they may incur and type of assets in which they may invest);
- the foreign private adviser exemption – investment advisers who are not holding themselves out to the public in the US as an investment adviser or advising registered funds, have no US place of business and have fewer than 15 US clients and investors in total in private funds, with assets under management (AUM) from such clients and US investors of less than US$25 million; and
- the private fund adviser exemption – investment advisers solely to private funds with AUM of less than US$150 million (discussed further below). However, for non-US investment advisers, the private fund adviser exemption provides that a non-US investment adviser would not be required to register as long as the following is true:
  - it has no client that is a US person except for qualifying private funds; and
  - any assets managed by such adviser at a place of business in the US are solely attributable to private fund assets the total value of which is less than US$150 million.

A private fund adviser with its principal office and place of business outside of the US that cannot meet the foreign private exemption can often rely on the private fund adviser exemption. Note that under the private fund adviser exemption, the type or number of non-US clients or the amount of assets managed outside of the US are not taken into account.

In determining whether an investment adviser can rely on these exemptions, the SEC considers an investment adviser's principal office and place of business as the location where the investment adviser controls the management of private fund assets, although day-to-day management of certain assets may take place at another location. An investment adviser with its principal office and place of business in the US must count all private fund assets, including those from non-US clients toward the US$150 million in calculating AUM. An investment adviser with its principal office and place of business outside of the US need only count private fund assets it manages at a place of business in the US toward the US$150 million limit. AUM are the securities portfolios for which an investment adviser provides continuous and regular supervisory or management services. An investment adviser provides 'continuous and regular supervisory or management services' with respect to a private equity fund from a place of business in the US if its US place of business has 'ongoing responsibility to select or make recommendations' as to specific securities or other investments the fund may purchase or sell and, if such recommendations are accepted by the fund, the investment adviser's US place of business is responsible for arranging or effecting the purchase or sale. However, the SEC does not view merely providing research or conducting due diligence to be continuous and regular supervisory or management services at a US place of business if a person outside of the US makes independent investment decisions and implements those decisions.

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Investment advisers relying on the venture capital fund exemption or the private fund adviser exemption are considered to be exempt reporting advisers (ERAs) and are required to report with the SEC by filing certain portions of Form ADV, Part 1 within 60 days of relying on the exemption. These portions require disclosure of certain basic information with respect to the investment adviser, its activities and the private funds that it advises. An adviser's Form ADV filing must be amended at least annually, within 90 days of the end of the investment adviser's fiscal year, and more frequently for certain specific changes. The SEC is authorised to require an ERA to maintain records and provide reports, and to examine such ERA's records, which means an ERA's books and records are subject to SEC inspection. The SEC has in the past indicated that it intends to examine ERAs as a part of the SEC's routine examination programme. ERAs are not required to file Form PF described below.

In addition to the exemptions described above, certain investment advisers are excluded from the definition of 'investment adviser' and thus are not required to register under the Advisers Act. For example, a 'family office', which is generally a company owned and controlled by family members that provides investment advice only to family clients and does not hold itself out to the public as an investment adviser is so excluded from the definition.

On the other hand, subject to certain exceptions, investment advisers with less than US$100 million in AUM are generally prohibited from registering with the SEC under the Advisers Act and must instead register as an investment adviser of the state in which they maintain a principal office and place of business and be subject to examination as an investment adviser by the applicable securities commissioner, agency or office.

Form PF

A registered investment adviser with more than US$150 million of private fund AUM is required to file Form PF with the SEC, which requires disclosure of certain basic identifying information regarding each "private fund" an investment adviser advises, including gross and net asset value, gross and net performance, use of leverage, aggregate value of derivatives, a breakdown of the fund's investors by category (eg, individuals, pension funds, governmental entities, sovereign wealth funds), a breakdown of the fund's equity held by the five largest investors and a summary of fund assets and liabilities. Hedge fund advisers are also required to report information about fund strategy, counterparty credit risk and use of trading and clearing mechanisms quarterly. Large private fund advisers are required to report more extensive information, with the nature of the information dependent upon their strategy. Additional disclosure requirements for registered investment advisers to private equity funds with more than US$2 billion AUM focus on fund guarantees of controlled portfolio company obligations, leverage of controlled portfolio companies and use of bridge financing for controlled portfolio companies. Additional disclosure requirements for registered investment advisers to hedge funds with more than US$1.5 billion AUM (large hedge fund advisers) must report on an aggregated basis information regarding exposures by asset class, geographical concentration and turnover, and for hedge funds with a net asset value of at least US$500 million, they must also report certain information relating to such fund's investments, leverage, risk profile and liquidity. For registered investment advisers that manage only private equity funds (as well as smaller hedge fund advisers), the form has to be filed annually, within 120 days of the fiscal year-end. Large hedge fund advisers must file Form PF on a quarterly basis within 60 days of the end of each fiscal quarter. Unlike Form ADV filings, which are available on the SEC's website, Form PF filings are confidential and such information is exempt from requests for information under FOIA. However, the SEC is required to share information included in Form PF filings with the Financial Stability Oversight Council and in certain circumstances US Congress and other federal departments, agencies and self-regulatory organisations (in each case, subject to confidentiality restrictions). We note that, for purposes of Form PF, a fund that is required to pay a performance fee based on unrealised gains to its investment adviser or has the ability to borrow in excess of a certain amount, or sell assets short is deemed to be a per se hedge fund.

Regulation applicable to unregistered advisers

Even unregistered investment advisers (whether ERAs or not) are subject to the general anti-fraud provisions of the Exchange Act, the Advisers Act (see question 6), state laws and, if required to register as a broker-dealer with the Financial Industry Regulatory Authority (FINRA) (see question 11), similar rules promulgated by FINRA, and the SEC and many of the analogous state regulatory agencies retain statutory power to bring actions against a private equity fund sponsor under these provisions.

US Commodity Futures Trading Commission (CFTC) regulation

The CFTC has the authority to regulate commodity pool operators (CPOs) and commodity trading advisers (CTAs) under the US Commodity Exchange Act. CFTC regulations broadly include most derivatives as 'commodity interests' that cause a private equity fund holding such instruments to be deemed a 'commodity pool' and its operator (typically the general partner, in the case of a limited partnership) to be subject to CFTC jurisdiction as a CPO and/or its adviser (typically the investment adviser) to be subject to CFTC jurisdiction as a CTA, and, in certain cases, to become a member of the National Futures Association (NFA), the self-regulatory organisation for the commodities and derivatives market. The CFTC regulations will generally apply on the basis of holding any commodity interest, directly or indirectly and, as such, CPO and CTA status should be considered with respect to all investment activities and products, including, for example, private funds, real estate investment trusts, separate managed account arrangements and any subsidiary entities, alternative investment vehicles and other related entities and accounts. CPOs managing private equity funds may claim certain exemptions from registration with the CFTC, which may include no-action relief (including for CPOs of 'funds of funds'), the 'de minimis' exemption under CFTC Rule 4.13(a)(3) (providing relief for CPOs that engage in limited trading of commodity interests on behalf of a commodity pool) and 'registration lite' under CFTC Rule 4.7 (providing relief from certain reporting and record keeping requirements otherwise applicable to a registered CPO if the interests in such pool are offered only to 'qualified eligible persons' (which includes a 'qualified purchaser' described in question 24 and 'non-United States persons')), and corresponding exemptions are available to CTAs of private equity funds. The confluence of regulatory measures taken in the post-financial crisis period, including the expansion of the meaning of commodity interests to include most swaps and the repeal of the broad exemption under CFTC Rule 4.13(a)(4), which was commonly relied upon by CPOs of private equity funds that rely on the 3(c)(7) exemption from registration under the Investment Company Act (ie, the qualified purchaser exemption described in question 24) effectively placed additional regulatory pressure on private equity fund sponsors to monitor whether their activities will deem their private equity funds to be commodity pools (eg, because the funds hedge their currency or interest rate exposure by acquiring swaps), and to appropriately assess the registration requirements for CPOs and determine whether they meet the de minimis exemption from such registration, which requires consideration of a number of factors early in the process of structuring a fund and throughout its term. If an exemption or other relief is not available, a sponsor of a fund that invests in commodity interests (including derivatives) may be required to register with the CFTC and NFA, in which case it will become subject to reporting, record-keeping, advertising, ethics training, supervisory and other ongoing compliance obligations and certain of its personnel will become subject to certain proficiency requirements (eg, the Series 3 exam) and standards of conduct. In an effort to harmonise the CFTC rules with the recent amendments to Rule 506 of Regulation D under the US Securities Act of 1933, as amended (the Securities Act) that afford private equity funds additional flexibility to engage in general solicitations and general advertising in connection with fundraising activities, subject to satisfying certain conditions and procedures (see question 24), the CFTC issued exemptive relief intended to allow private equity fund sponsors relying on the de minimis exemption or registration lite to take advantage of the additional flexibility to engage in general solicitation by effectively conforming the CFTC rules to the previously adopted Rule 506 amendments.

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11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

The offering and sale of interests in a private equity fund are typically conducted as 'private placements' exempt from the securities registration requirements imposed by the Securities Act, the regulations thereunder and applicable state law. In addition, most private equity funds require their investors to meet certain eligibility requirements so as to enable the funds to qualify for exemption from regulation as investment companies under the Investment Company Act. Accordingly, there are no approval, licensing or registration requirements applicable to a private equity fund that offers its interests in a valid private placement and qualifies for an exemption from registration under the Investment Company Act.

As a general matter, if 25 per cent or more of the total value of any class of equity interests in a private equity fund is held by 'benefit plan investors', such as US corporate pension plans and individual retirement accounts as well as entities whose assets include plan assets (such as a fund of funds) (excluding non-Employee Retirement Income Security Act (ERISA)-plans, such as US governmental pension plans and non-US pension plans), the private equity fund must be operated to qualify as an 'operating company' such as a 'venture capital operating company' (VCOC) or a 'real estate operating company' (REOC). Qualification as a VCOC generally entails the private equity fund having on its initial investment date and annually thereafter at least 50 per cent of the private equity fund's assets, valued at cost, invested in operating companies as to which the private equity fund obtains direct contractual management rights. The private equity fund must exercise such management rights with respect to one or more of such operating companies during the course of each year in the ordinary course of business.

The sponsor of a private equity fund engaging in certain types of corporate finance or financial advisory services may be required to register as a broker-dealer with FINRA and be subject to similar audit and regulation.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

In the absence of an applicable exemption, exception or prohibition, a private equity fund's manager will be subject to registration as an investment adviser under the Advisers Act. (See question 10.)

Those investment advisers registered under the Advisers Act (whether voluntarily or because an exemption, exception or prohibition is not available) are subject to a number of substantive reporting and record-keeping requirements and rules of conduct that shape the management and operation of their business, as well as periodic compliance inspections conducted by the SEC and certain state regulators.

As part of the shift towards more systematic regulation and increased scrutiny of the private equity industry, the SEC continues to focus on the examination of private equity firms. Certain private equity industry practices have received significant attention from the SEC and have led to a number of enforcement actions against private equity fund advisers in recent years. Areas that the SEC has highlighted to be of particular concern include, among others, the following:

- allocation of expenses to funds or portfolio companies, or both, without pre-commitment disclosure and agreement from investors (including for the compensation of operating partners, senior advisers, consultants and seconded and other employees of private equity fund advisers or their affiliates for providing services (other than advisory services) to funds or portfolio companies or both);
- full allocation of broken deal expenses to funds instead of separate accounts, co-investors or co-investment vehicles without pre-commitment disclosure and agreement from investors;
- marketing presentations, and the presentation of performance information generally;
- receipt by private equity firms of compensation from funds or portfolio companies, or both, which is outside of the typical management fee or carried interest structure, without pre-commitment disclosure and agreement from investors as well as an acceleration of monitoring fees;
- receipt by private equity firms of transaction-based or other compensation for the provision of brokerage services in connection with the acquisition and disposition of portfolio companies without being registered as a broker-dealer;
- allocation of investment opportunities among investment vehicles they manage and between such funds and the private equity fund advisers, affiliates or employees;
- allocation of co-investment opportunities;
- disclosure of other conflicts of interests to investors, including those arising out of the outside business activities of a private equity sponsor's employees and directors;
- valuation methods;
- receipt of service provider discounts by private equity firms that are not given to the funds or portfolio companies without pre-commitment disclosure and agreement from investors;
- plans to mitigate or respond to cybersecurity events;
- failure to fully allocate fees from portfolio companies to management fee paying funds to offset such management fees without pre-commitment disclosure and agreement from investors; and
- allocation of interest from a loan to the private equity fund adviser only to the adviser or its affiliates without pre-commitment disclosure and agreement from investors.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

There are no particular educational or experience requirements imposed by law on investment advisers, although the education and experience of certain of an investment adviser's personnel are disclosable items in the Form ADV. As a matter of market practice, the required experience level of an investment adviser's management team will be dictated by the demands of investors. If required to register as a broker-dealer with FINRA, a private equity fund sponsor would need to satisfy certain standards in connection with obtaining a registration (eg, no prior criminal acts, minimum capital, testing, etc). Also, a private equity fund's sponsor is typically expected to make a capital investment either directly in or on a side-by-side basis with the private equity fund (but see question 16 with respect to limitations on sponsor commitments in bank-sponsored private equity funds). Investors will expect that a significant portion of this investment be funded in cash, as opposed to deferred-fee or other arrangements.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

The SEC has adopted Rule 206(4)-5, a broad set of rules aimed at curtailing 'pay-to-play' scandals in the investment management industry. The rules, subject to certain de minimis exceptions, prohibit a registered investment adviser, as well as an ERA and a foreign private adviser (covered advisers), from providing advice for compensation to any US government entity within two years after the covered adviser or certain of its executives or employees (covered associates) has made a political contribution to an elected official or candidate who is in a position to influence an investment by the government entity in a fund advised by such investment adviser. The rules also make it illegal for the covered adviser itself, or through a covered associate, to solicit or coordinate contributions for any government official (or political party) where the investment adviser is providing or seeking to provide investment advisory services for compensation to a government entity in the applicable state or locality. Investment advisers are also required to monitor and maintain records relating to political contributions made by their employees.

In addition to the SEC rule, certain US states (including California, New Mexico, New Jersey and New York) have enacted legislation

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and certain US public pension plans (including the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), the New Mexico State Investment Council and the New York State Common Retirement Fund) have established policies that impose similar restrictions on political contributions to state officials by investment advisers and covered associates.

15 Use of intermediaries and lobbyist registration

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.

With effect from 20 August 2017, the SEC's pay-to-play rules discussed above broadly prohibit a covered adviser from making any payment to a third party, including a placement agent, finder or other intermediary, for securing a capital commitment from a US government entity to a fund advised by the investment adviser unless such placement agent is registered under section 15B of the Exchange Act and subject to pay-to-play rules adopted by the Municipal Securities Rulemaking Board or FINRA. The ban does not apply to payments by the investment adviser to its employees or owners.

Certain US states have enacted legislation regulating or prohibiting the engagement or payment of placement agents by an investment adviser with respect to investment by some or all of such state's pension systems in a fund advised by such investment adviser. Such regulations and prohibitions vary from state to state. For example, California has enacted legislation that requires placement agents, which can include third-party placement agents as well as the investment manager's employees, officers, directors and other equity holders (unless such persons spend at least a third of their time managing the securities or assets invested by the investment adviser), to register as lobbyists before soliciting investments from its state-level public pension plans (CalPERS, CalSTRS and the University of California to the extent it is investing retirement (as opposed to endowment) assets). The California law also prohibits placement agents from receiving fees that are contingent on securing investments from the plans and requires disclosure of any fixed placement fees or other compensation paid to solicit investments from such state pension plans.

The California law requiring placement agents to register as lobbyists may also require such registration of certain of an investment adviser's own employees and partners who are involved with the solicitation of investments from the California state pension plans, such as marketing or investor relations personnel. The compensation paid to such employees and partners of the investment adviser who directly solicit the plan is also required to be disclosed. In addition, investment advisers who retain third-party placement agents to solicit the California state pension plans or whose employees and partners are covered by the lobbyist-registration law are considered 'lobbyist employers' under California law and are required to make certain public filings in addition to such placement agents and employees. Kentucky has also recently adopted registration requirements with respect to placement agents soliciting investments from Kentucky state pension plans that are similar to those applicable to California state public pension plans. Various other states may also have lobbying laws that effectively require investment advisers and their employees who solicit state and local pension plans to register as lobbyists. Counties, cities or other municipal jurisdictions may require lobbyist registration or disclosure or both. For example, in New York City, local rules effectively require investment advisers and their employees who solicit local pension plans to register as lobbyists.

In addition, public pension plans may have their own additional requirements. In states where state law does not ban placement agent fees or require disclosure, the public pension plans themselves may have such bans or requirements.

16 Bank participation

Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.

In 2013, the five US regulatory agencies responsible for implementing the 'Volcker Rule' provisions of Dodd-Frank approved final rules (the 'Final Rules') that generally prohibit 'banking entities' from acquiring or retaining any ownership in, or sponsoring, a private equity fund (and engaging in proprietary trading). For purposes of the Final Rules, the term 'banking entity' means any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of the International Banking Act (such as a foreign bank that has a US branch, agency or commercial lending subsidiary) and any affiliate or subsidiary of such entities.

There are a number of exceptions to the basic prohibition on banking entities investing in or sponsoring private equity funds. In particular, banking entities are permitted to invest in covered private funds that they sponsor, provided that the investment does not exceed 3 per cent of the fund's total ownership interest or 3 per cent of the banking entity's 'Tier 1 capital', and provided that certain other conditions are met. For these purposes, a covered fund generally include funds that would be investment companies but for the exemptions provided by section 3(c)(1) or section 3(c)(7) of the Investment Company Act.

The Trump administration has indicated it supports the repeal or modification of key aspects of the Volcker Rule, but whether such legislation will be enacted (or in what ultimate form) is uncertain.

Taxation

17 Tax obligations

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Generally, a private equity fund vehicle, such as a limited partnership or limited liability company, that is treated as a partnership for US federal income tax purposes, would not itself be subject to taxation with respect to its income or gains. Instead, each partner would take into account its distributive share of the partnership's income, gain, loss and deduction.

Recently enacted legislation that is scheduled to become effective for taxable years beginning after 31 December 2017, however, may impose liability for adjustments to a fund's tax returns on the fund itself in certain circumstances in the absence of an election to the contrary. The effects of the application of this new legislation on private equity funds is uncertain.

If the fund generates income that is effectively connected with the conduct of a US trade or business (ECI), including as a result of an investment in US real estate or certain real estate companies, the fund will be required to withhold US federal income tax with respect to such income that is attributable to the fund's non-US investors, regardless of whether it is distributed. In general, subject to an exception for investments in certain real estate companies, trading in stock or securities (the principal activity of most private equity funds) is not treated as generating ECI.

The fund will also be required to withhold with respect to its non-US investors' distributive share of certain US-source income of the fund that is not ECI (eg, US-source dividends and interest) unless, in the case of interest, such interest qualifies as portfolio interest. Portfolio interest generally includes (with certain exceptions) interest paid on registered obligations with respect to which the beneficial owner provides a statement that it is not a US person. A non-US investor who is a resident for tax purposes in a country with respect to which the US has an income tax treaty may be eligible for a reduction or refund of withholding tax imposed on such investor's distributive share of interest and dividends and certain foreign government investors may also be eligible for an exemption from withholding tax on income of the fund that is not from the conduct of commercial activities.

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The foreign account tax compliance act requires all entities in a broadly defined class of foreign financial institutions (FFIs) to comply with a complicated and expansive reporting regime or be subject to a 30 per cent withholding tax on certain payments (and beginning in 2019, a 30 per cent withholding tax on gross proceeds from the sale or other disposition of US stocks and securities). This legislation also requires non-US entities that are not FFIs either to certify they have no substantial US beneficial ownership or to report certain information with respect to their substantial US beneficial ownership or be subject to a 30 per cent withholding tax on certain payments (and, beginning in 2019, a 30 per cent withholding tax on gross proceeds from the sale of US stocks and securities). This legislation could apply to non-US investors in the fund, and the private equity fund could be required to withhold on payments to such investors if such investors do not comply with the applicable requirements of this legislation.

The taxation of a private equity fund vehicle as a partnership for US federal income tax purposes is subject to certain rules regarding 'publicly traded partnerships' that could result in the partnership being classified as an association taxable as a corporation. To avoid these rules, funds are not commonly traded on a securities exchange or other established over-the-counter market and impose limitations on the transferability of interests in the private equity fund vehicle.

18 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors that invest directly in a private equity fund organised as a flow-through vehicle in the US would be subject to US federal income taxation and return filing obligations if the private equity fund (or an entity organised as a flow-through vehicle into which the private equity fund invests) generates ECI (including gain from the sale of real property or stock in certain 'US real estate property holding corporations') (see question 17). In addition, all or a portion of the gain on the disposition (including by redemption) by a non-US investor of its interest in the fund may be taxed as ECI. Similar US state and local income tax requirements may also apply.

19 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, no tax ruling would be obtained with respect to the tax treatment of a private equity fund vehicle formed in the US. While there are many special taxation rules applicable to US investors, of particular relevance are those rules that apply to US tax-exempt investors in respect of unrelated business taxable income (UBTI).

20 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

There are no significant taxes associated with the organisation of a private equity fund in the US.

21 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

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 (see question 32).

Under the Tax Reform Bill, the fund must have a three-year holding period (rather than the standard one-year holding period) for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment. In addition, an individual carried interest participant will only be eligible for long-term capital gain treatment upon disposition of any interests in a carry vehicle (other than capital interests) if such participant has a three-year holding period for the interests. Further, Congress has previously proposed legislation 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 US federal income tax than are currently in effect. Whether such legislation would be enacted in addition to changes in the Tax Reform Bill is uncertain.

In addition, some sponsors implement arrangements in which a sponsor waives its right to all or a portion of management fees in order for it or an affiliate to receive an additional distributive share of the private equity fund's returns. Proposed regulations, if finalised, could treat participants in such management fee waiver arrangements as receiving compensatory payments for services rather than allocations of the fund's underlying income. The preamble to the proposed regulations also indicates that existing safe harbours that treat the grant of a 'profits interest' as a non-taxable event may not apply to management fee waiver arrangements.

22 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The US has an extensive network of income tax treaties. How a treaty would apply to the fund vehicle depends on the terms of the specific treaty and the relevant facts of the structure.

23 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

The Tax Reform Bill has resulted in fundamental changes to the tax code. Among the numerous changes included in the Tax Reform Bill are:

- a permanent reduction to the corporate income tax rate;
- a partial limitation on the deductibility of business interest expense;
- an income deduction for individuals receiving certain business income from pass-through entities;
- changes in the treatment of carried interest, which generally requires the fund to have a three-year holding period for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment (as further described in question 21);
- a partial shift of the US taxation of multinational corporations from a tax on worldwide income to a territorial system (along with a transitional rule that taxes certain historical accumulated earnings and rules that prevent tax planning strategies that shift profits to low-tax jurisdictions); and
- a suspension of certain miscellaneous itemised deductions, including deductions for investment fees and expenses, until 2026.

The partial limit on the deductibility of business interest expense disallows deductions for business interest expense (even if paid to third parties) in excess of the sum of business interest income and 30 per cent of the adjusted taxable income of the business. Business interest includes any interest on indebtedness related to a trade or business, but excludes investment interest, to which separate limitations apply. The impact of the Tax Reform Bill on funds and their portfolio companies is uncertain.

US tax rules are very complex and tax matters play an extremely important role in both fund formation and the structure of underlying fund investments. Consultation with tax advisers with respect to the specific transactions or issues is highly recommended.

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Selling restrictions and investors generally

24 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

Exemptions from requirement to register fund interests

To ensure that a private equity fund offering securities in the US will satisfy the requirements necessary to avoid registration of the interests in the fund with the SEC, a private equity fund sponsor will customarily conduct the offering and sale of interests in the private equity fund to meet a private placement exemption under the Securities Act. The most reliable way to do this is to comply with the 'safe harbour' criteria established by Rule 506 under Regulation D under the Securities Act. Compliance with these criteria effectively necessitate, among other requirements, that each investor in the private equity fund be an accredited investor (which generally includes a natural person with a net worth of more than US$1 million or income above US$200,000 in the last two years (or US$300,000 in joint income with a spouse for those years and a reasonable expectation of reaching the same income level in the current year), and entities with more than US$5 million in assets). For purposes of the US$1 million net-worth test described above, the value of the investor's primary residence is excluded from the calculation of the investor's total assets and the amount of any mortgage or other indebtedness secured by an investor's primary residence is similarly excluded from the calculation of the investor's total liabilities, except to the extent the fair market value of the residence is less than the amount of such mortgage or other indebtedness. There is also a timing provision in the net-worth test designed to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence to acquire assets that would be included in the net worth calculation. Under the timing provision, if a borrowing occurs in the 60 days preceding the purchase of securities in an exempt offering and is not in connection with the purchase of the primary residence, the incremental indebtedness must be treated as a liability for the net worth calculation, even if the value of the primary residence exceeds the aggregate amount of debt secured by the primary residence. The SEC is authorised to adjust the 'accredited investor' definition for individuals every four years as may be appropriate to protect investors, further the public interest or otherwise reflect changes in the prevailing economy.

In addition to satisfying the accredited investor criteria, the sponsor must either not make any offers or sales by means of general solicitation or general advertising in which case it can rely on the more traditional Rule 506(b) exemption or, if it does make any offer or sale by means of general solicitation and general advertising in connection with fundraising activities, the sponsor must comply with additional requirements, including enhanced verification procedures (that do not apply to offerings that do not involve any general solicitation or general advertising) in order to rely on the exemption in Rule 506(c).

The additional requirements of Rule 506(c), which are substantial, are as follows:

- that all purchasers of securities qualify as accredited investors; and
- that the issuer takes 'reasonable steps' to verify the accredited investor status of all purchasers.

Rule 506(c) provides some non-exclusive, non-mandatory methods of verifying that a natural person is accredited (eg, reviewing tax returns or bank account statements) and to the extent these methods are not used, or a sponsor is verifying the accredited investor status of an entity, in determining whether the steps taken by an issuer to verify eligibility are objectively reasonable, sponsors should consider the particular facts and circumstances of each offering and each purchaser, including the following:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature, terms and manner of the offering.

Given that these increased verification measures with respect to sales under Rule 506(c) generally result in increased compliance burdens and costs for issuers, and in some cases, investors are reluctant to provide or are sensitive about providing the additional information required as part of the enhanced verification procedures, private equity firms are not yet widely utilising Rule 506(c), and Rule 506(c) is not expected to play a significant role in private equity fundraising in the future.

Other factors impeding utilisation of Rule 506(c) by private equity firms are that use of general solicitation in reliance on Rule 506(c) may impact other aspects of a private equity sponsor's regulatory compliance regime and the potential impact of pending SEC proposed amendments to Rule 506 that would create additional burdens for reliance on Rule 506(c), as described further below. For example, it is possible that the use of general solicitation or general advertising by a private equity fund under Rule 506(c) could have an adverse impact on its private placement under the securities laws of other jurisdictions in which it conducts its offering as the securities laws thereof may not permit general solicitation in their current form.

A private equity fund relying on a private placement safe harbour contained in Regulation D under the Securities Act must file electronically with the SEC a notice on Form D within 15 calendar days after the first sale of securities. Form D sets forth certain basic information about the offering, including the amount of securities offered and sold as well as whether any sales commissions were paid to any broker-dealers and, if so, the states in which purchases were solicited by such broker-dealer. For purposes of the Form D filing deadline, the SEC considers the first date of sale to occur on the date on which the first investor is irrevocably contractually committed to invest. Therefore, depending on the terms and conditions of the contract, such date could be deemed to be the date on which a private equity fund receives its first investor subscription agreement and not necessarily the typically later closing date. The SEC has proposed amendments to Regulation D, which would impose additional procedural requirements on issuers seeking to rely on Rule 506(c) to engage in a general solicitation by requiring that an initial Form D (with heightened disclosure requirements) be filed at least 15 days before commencing any such general solicitation and that a final amendment to Form D be filed within 30 days of the termination of any such offering. Under other proposed amendments, failure to comply with the Form D filing requirements (whether or not involving a general solicitation) would result in an automatic one-year disqualification from relying on a Rule 506 safe harbour.

In addition to federal securities law compliance, most states have similar notice-filing requirements. While state registration of securities is pre-empted under the Securities Act, private equity sponsors should be cognisant of the state law notice-filing requirements in the various jurisdictions in which they will or have offered or sold limited partnership interests to investors. Many states require a notice filing, consisting of a copy of a Form D and a filing fee, to be made within 15 calendar days after the first sale in the state. Anti-fraud provisions under applicable state laws apply despite the pre-emption described above.

Issuers are prohibited from relying on the Rule 506 safe harbour (whether or not the proposed offering involves a general solicitation), if the issuer or any other 'covered person' was subject to a 'disqualifying event'. Covered persons include the issuer and its predecessors, affiliated issuers (ie, issuers that issue securities in the same offering, such as parallel funds and related feeder funds), directors and certain officers, general partners and managing members of the issuer, beneficial owners of 20 per cent or more of an issuer's outstanding voting equity securities calculated on the basis of voting power (which could include limited partners in related private equity funds if the issuer and such related fund vote together), any investment manager to a pooled investment fund issuer, any 'promoter' connected with the issuer and any persons compensated for soliciting investors (eg, placement agents), as well as the general partners, directors, officers and managing members of any such investment manager or compensated solicitor. For purposes of the bad actor rules, disqualifying events include certain criminal convictions, court injunctions and restraining orders, final orders of state and federal regulators, SEC disciplinary orders, stop orders and cease-and-desist orders, suspension or expulsion from a securities self-regulatory organisation and US Postal Service false representation orders. Disqualification is not triggered by actions taken in jurisdictions other than the US. A number of the disqualifying events are required to occur in connection with the purchase or sale of

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Update and trends

- 2017 was a record year for private equity fundraising, surpassing levels from prior years. According to Preqin, 921 private equity funds reached a final close in 2017, with a total of US$453 billion in commitments, which is an all-time fundraising record for the private equity industry and surpasses the record set in 2007 of US$414 billion raised by 1,045 funds. In addition, such fundraising totals represent a 9 per cent increase over 2016 during which US$414 billion was raised by 1,243 funds.
- Fundraising by North America-focused private equity funds in 2017 totalled approximately US$272 billion, a record-breaking amount representing a 44 per cent increase over the US$188 billion raised in 2016. In addition, North America was the most targeted market of 2017 as approximately 51 per cent of all private equity funds closed in 2017 were primarily focused on North America, according to Preqin. Europe-focused private equity fundraising remained relative steady in 2017 and Asia-focused private equity funds raised 60 per cent more capital in 2017 than in 2016.
- Private equity fundraising conditions continue to favour established sponsors with strong track records as the industry trend towards consolidation and the 'flight to quality' continues. For example, in 2017 over 26 per cent fewer funds closed than in 2016, causing the average fund size to reach a record US$535 million, according to Preqin. A key driver of this consolidation has been institutional limited partners often seeking to make larger commitments to fewer funds and consolidating their relationships among a smaller group of fund managers.
- In addition, private equity fundraising was driven in 2017 by the resurgence of 'mega-funds'. According to Preqin, 28 per cent of the private equity capital raised in 2017 was raised by the 10 largest funds closed and 42 per cent was raised by the 20 largest funds closed. Eighty of the private equity funds that reached a final close in 2017 secured US$1 billion or more in capital.
- 2017 also saw an increased acceleration in the pace of fundraising as 30 per cent of the funds closed in 2017 were in market for less than six months.
- The continued focus on strategic relationships and alternative fundraising strategies, including customised and/or multi-strategy separate account arrangements, co-investment arrangements, 'umbrella' arrangements and other anchor or strategic investments, has played a significant role in private equity fundraising in recent years. Notably, co-investments, direct investments and separate accounts as well as early-closer incentives and other accommodations in terms continued to play an increased role in private equity fundraising in 2017.
- As investors continue to consolidate their relationships within the private equity industry and key investors seek to strengthen bonds with certain private equity sponsors, dedicated investor relations teams have developed at private equity firms to comply with investors' demands for customised rights (eg, reporting and transparency) and increased scrutiny of marketing materials.
- As sponsors continue to focus on alternative ways to raise capital in today's environment, a number of established sponsors are considering raising lower-risk, longer-term funds ('core' funds), and a number of sponsors have increased their focus on raising 'complementary' funds (eg, funds with strategies aimed at particular geographic regions or specific asset types).
- The strong performance by private equity funds and record distributions to investors in recent years has provided an ongoing source of liquidity for many institutional investors and has led to an increase in overall allocations to private equity for many institutional investors, broadening both the breadth and depth of the private equity asset class among investors. Moreover, given that private equity as an asset class has outperformed the public markets and has been more stable relative to the volatility in the public markets in recent years, institutional investors may increasingly shift allocations from the public markets to private equity. Given this, funds possess a nearly unprecedented amount of dry powder, or capital not yet deployed, with US$1 trillion on hand as of December 2017, according to Preqin. However, it should be noted that such record levels of dry powder are not necessarily a positive for the private equity industry; asset prices remain high and, as such, aggregate deal value is continuing to decrease, making it difficult for fund managers to deploy such excess capital.
- As a result of the strength of private equity fundraising in recent years, established sponsors are seeking more sponsor-favourable fund terms in an effort to reverse terms put into place around the onset of the global financial crisis and realign interests between themselves and investors.
- It is expected that the SEC will continue to focus on transparency (eg, pre-commitment disclosure and consent from investors) with respect to conflicts of interest, among other matters. As a result, fund documentation is likely to remain complex and more granular reporting will continue to be provided on a variety of topics, including fees and allocation of costs and expenses. Recent SEC enforcement actions have focused on, among other things, the allocation of costs and expenses to funds or portfolio companies, the allocation of co-investment opportunities, the receipt by private equity firms of compensation or other fees or compensation from funds or portfolio companies, which are outside of the typical management fee or carried interest, and conflicts of interest related thereto, and has caused many private equity firms to carefully reconsider and enhance their disclosure and practices with respect thereto.
- Continued regulatory constraints (particularly among banks and other financial institutions) have increased the role played by sovereign wealth funds and high-net-worth investors (eg, bank feeders) in the private equity asset class.
- A number of the larger and more established private equity firms continue to face distinct firm issues relating to the interplay between their status as public companies and their sponsorship and management of private funds.
- We expect that fundraising for 2018 will remain strong as a record 2,296 private equity funds are seeking to raise approximately US$744 billion as of the beginning of 2018, despite continuing economic concerns and wider political volatility, according to Preqin. We also expect that the trends and developments witnessed in 2017 will continue in the near-to-medium term as the consolidation in the private equity industry continues. Competition to secure limited partnership capital among private equity funds will remain high and continue to increase in 2018, with alternative fundraising strategies continuing to play a substantial role. Increasingly, risk-averse allocation decisions by investors, coupled with the volatility in the public markets, will continue to allow established sponsors with proven track records to enjoy a competitive advantage. Regulatory constraints are likely to continue to create opportunities for private equity firms and may result in continued opportunity in secondary and private debt businesses of private equity sponsors.

securities and include a look-back period of five to 10 years depending on the particular facts surrounding the disqualifying event. While only disqualifying events that occur after the rule's effective date (23 September 2013) will disqualify an issuer from relying on Rule 506, disqualifying events that occurred prior to such date but within the applicable look-back period would nonetheless be required to be disclosed to investors in connection with any sales of securities under Rule 506. The bad actor rules will not apply if an issuer can show that it did not know and, in the exercise of reasonable care could not have known, that the issuer or any other covered person was subject to a disqualifying event, although this reasonable care exception requires factual inquiry. Additionally, the SEC may grant waivers from disqualification under certain circumstances, including if the issuer has undergone a change of control subsequent to the disqualifying event.

Exemptions from requirement to register funds

To ensure that a private equity fund will satisfy the requirements necessary to avoid regulation as an 'investment company' under the Investment Company Act, each investor in the fund will typically be required to represent that it is a qualified purchaser as defined in section 2(a)(51) of the Investment Company Act. In the event that not all of a private equity fund's investors are qualified purchasers, the fund may still qualify for an exemption (the 3(c)(1) exemption) by limiting the number of investors to not more than 100 (all of which must still be accredited investors and with respect to which certain 'look through' attribution rules apply). A qualified purchaser generally includes a natural person who owns not less than US$5 million in investments, a company acting for its own account or the accounts of other qualified purchasers that owns and invests on a discretionary basis not less than US$25 million in investments and certain trusts. 'Knowledgeable

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employees' (namely, executive officers and directors of the sponsor and most investment professionals actively involved with the private equity fund's investment activities) are ignored for the purposes of the foregoing requirements. If the sponsor of a private equity fund is a registered investment adviser under the Advisers Act, then in certain circumstances each investor may need to represent that it is a 'qualified client' as defined under the Advisers Act. A qualified client generally includes a natural person or company with a net worth exceeding US$2.1 million or that has US$1 million under management with the investment adviser, although the SEC is required every five years to adjust these dollar amounts for inflation, excluding the value attributable to such person's primary residence (as further described above).

25 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Other than compliance with certain aspects of the anti-money laundering provisions of the USA PATRIOT Act (the Patriot Act) discussed in question 28, as a general matter there are no such restrictions other than those imposed by applicable securities laws described above or which may arise under the laws of other jurisdictions. Sponsors of private equity funds may choose to limit participation by certain types of investors in light of applicable legal, tax and regulatory considerations and the investment strategy of the fund. Restrictions may be imposed on the participation of non-US investors in a private equity fund in investments by the private equity fund in certain regulated industries (eg, airlines, shipping, telecommunications and defence). (See question 16 with respect to recently enacted restrictions on bank holding companies investing in private equity funds.)

26 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

There is generally no requirement to notify the state of Delaware or the SEC as a result of a change in the identity of investors in a private equity fund formed in Delaware (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership of the fund. However, in the case of a manager who is an investment adviser registered under the Advisers Act or an ERA, changes in identity of certain individuals employed by or associated with the investment adviser must be reflected in an amendment to Part 1 of the investment adviser's Form ADV promptly filed with the SEC, and in certain circumstances a change of management or control of the fund or of the manager or investment adviser may require the consent of the investors in the private equity fund. In the event of a change of the general partner of a Delaware limited partnership, an amendment to the fund's certificate of limited partnership would be required to be filed in Delaware and such change would need to be accomplished in accordance with such limited partnership's partnership agreement. Additionally, a private equity fund that makes an investment in a regulated industry, such as banking, insurance, airlines, telecommunications, shipping, defence, energy and gaming, may be required to disclose the identity and ownership percentage of fund investors to the applicable regulatory authorities in connection with an investment in any such company.

27 Licences and registrations

Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?

Generally, the sponsor of a private equity fund in the US would not be required to register as a broker or dealer under the Exchange Act as they are not normally considered to be 'engaged in the business' of brokering or dealing in securities. The rules promulgated under the Exchange Act provide a safe harbour from requiring employees and issuers to register as a broker or dealer subject to certain conditions, including such employees not being compensated by payment of commissions or other remunerations based either directly or indirectly on the offering of securities. If compensation is directly or indirectly paid to employees of the sponsor in connection with the offering of securities, the sponsor may be required to register as a broker-dealer (see questions 10 and 11). If a private equity fund retains a third party to market its securities, that third party generally would be required to be registered as a broker-dealer.

28 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.

Although private equity funds generally have historically not been subject to the anti-money laundering regulations of the Patriot Act, on 25 August 2015, the Financial Crimes Enforcement Network (FinCEN), a bureau of the US Department of the Treasury, proposed regulations that would impose anti-money laundering obligations on investment advisers registered with the SEC under the Advisers Act (Covered Advisers). Covered Advisers would be included in the definition of 'financial institution' in regulations implementing the Patriot Act and, consequently, would be required, among other things, to establish and implement risk-based anti-money laundering programmes and file suspicious activity reports with FinCEN. The proposed rules do not, however, include a customer identification programme requirement, as required for other financial institutions. FinCEN proposes delegating authority to the SEC to examine compliance with the proposed rules.

Although these proposed rules are not currently effective, as a best practice many private equity funds have already put into place anti-money laundering programmes that meet the requirements set forth in the Patriot Act's regulations. These requirements include the following:

- developing internal policies, procedures and controls;
- designating an anti-money laundering compliance officer;
- implementing an employee training programme; and
- having an independent audit function to test the programme.

Currently, there are no regulations in effect that would require the disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor. If an investment adviser to a private equity fund is registered under the Advisers Act, the investment adviser must disclose on Form ADV the educational, business and disciplinary background of certain individuals employed by or associated with the investment adviser. Similar disclosure may be required for investment advisers that are or have affiliates that are broker–dealers registered with FINRA. (See also question 10 for disclosure obligations under Form PF.)

Exchange listing

29 Listing

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

Because of certain adverse tax consequences arising from status as a publicly traded partnership and the difficulty that such a listing would impose on being able to establish an exemption from registration under the Investment Company Act, private equity funds do not typically list on a securities exchange in the US (see also question 17). The applicable listing requirements would be established by the relevant securities exchange.

30 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

As discussed above, private equity funds do not typically list on any US exchange. However, if listed, the ability of such a fund to restrict

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transfers of its interest would be dictated by the listing requirements of the relevant securities exchange as well as the other governing agreements of such fund.

Participation in private equity transactions

31 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

The primary restrictions concerning the types of investments that a private equity fund may make are typically contained in the private equity fund's limited partnership agreement. These restrictions often include limits on the amount of capital (typically expressed as a percentage of the fund's capital commitments) that may be deployed in any one investment, a restriction on participation in 'hostile' transactions, certain geographic diversification limits, a restriction on investments that generate certain types of tax consequences for investors (eg, UBTI for US tax-exempt investors or ECI for non-US investors), a restriction on certain types of investments (eg, venture capital investments, 'blind pool' investments, direct investments in real estate or oil and gas assets) and so on. Individual investors in a private equity fund may also have the right (either pursuant to the partnership agreement or a side letter relating thereto) to be excused from having their capital invested in certain types of investments (tobacco, military industry, etc) and to participate in certain types of investments in a certain manner (eg, to participate in UBTI or ECI investments through an alternative investment vehicle or an entity treated as a corporation for US federal tax purposes, or both).

There may also be limits on and filing requirements associated with certain types of portfolio investments made by a private equity fund. For example, investments in certain media companies may implicate the ownership limits and reporting obligations established by the US Federal Communications Commission. Other similarly regulated industries include shipping, defence, banking and insurance. Regulatory considerations applicable to mergers and acquisitions transactions generally (eg, antitrust, tender-offer rules, etc) also apply equally to private equity transactions completed by funds. Consideration should also be given to the potential applicability of the Sarbanes-Oxley Act and applicable US state laws relating to fraudulent conveyance issues, as discussed in more detail in the US Transactions chapter.

In addition, in general if benefit plan investors hold 25 per cent or more of the total value of any class of equity interests in the private equity fund, the private equity fund may, to avoid being subject to the fiduciary responsibility standard of care under ERISA and prohibited transaction rules under ERISA and the Code, need to structure its investments in a manner so as to ensure that the private equity fund will qualify as a VCOC or an REOC within the meaning of the ERISA plan asset regulations. Qualification as a VCOC generally entails having on its initial investment date and annually thereafter at least 50 per cent of the private equity fund's assets, valued at cost, invested in operating companies as to which the private equity fund obtains direct contractual 'management rights' and exercising such management rights with respect to one or more of such operating companies during the course of each year in the ordinary course of business.

32 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Depending on the state in which a private equity fund is formed and operates, there may be tax advantages to forming separate entities to receive the carried interest and management fee (and other fee) payments in respect of the fund and other unique structuring requirements. For example, funds whose manager has a place of business in New York City typically use this bifurcated structure. Additionally, as noted in question 21, the Tax Reform Bill requires funds to have a three-year holding period (rather than the standard one-year holding period) for an investment or asset in order for carried interest distributions to be eligible for favourable long-term capital gain treatment. In addition, an individual carried interest participant will only be eligible for long-term capital gain treatment upon disposition of any interests in a carry vehicle (other than capital interests) if such participant has a three-year holding period for the interests. Further, Congress has previously proposed legislation that, if enacted, would result in typical carried interest distributions being taxed at a higher rate, and proposed regulations and related guidance may limit the tax benefits of management fee waiver arrangements. Moreover, tax rules limit a sponsor's ability to use fee deferral arrangements to defer payment of tax on compensation and similar profits allocations.

The sponsor's ability to take transaction fees is likely to be the subject of negotiation with investors in the fund, who may seek to have a portion of such fees accrue for their account as opposed to that of the sponsor through an offset of such fees against the management fee otherwise to be borne by such investors. In certain circumstances, depending on the structure of a private equity fund, the manner in which a sponsor may charge a carried interest or management fee can be affected by the requirements of ERISA or the Advisers Act.

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity acquisitions in Australia commonly involve a private equity fund acquiring 100 per cent or a controlling interest in a private or a public company. Acquisitions of private companies are usually structured as a share purchase, asset purchase or share subscription while acquisitions of public companies tend to be structured as a takeover, members' scheme of arrangement or shareholder-approved acquisition of, or subscription for, shares. Where 100 per cent of a public company is acquired, the transaction is referred to as a public-to-private transaction. Acquisitions of interests in public companies require significantly greater disclosure than acquisitions of private companies and are more highly regulated.

Most private equity acquisitions are structured as leveraged acquisitions, such that they are funded through a combination of equity and third-party debt. The level of leverage depends on a number of factors, including the stage of life cycle of the acquired business and tax limitations on gearing.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The Australian Securities Exchange (ASX) Listing Rules and Corporations Act 2001 (Cth) (Corporations Act) impose various restrictions on corporate transactions involving public companies as well as a number of ongoing obligations.

Where a private equity transaction involves the acquisition of an interest in a public company, the following is true:

- the acquisition of an interest that takes the bidder's overall interest in the company to 20 per cent or more can only be conducted through limited types of regulated transactions. The most common forms of regulated acquisitions are takeover offers and members' schemes of arrangement;
- any acquisition of a pre-bid stake in circumstances where the bidder has non-public information about the target may be restricted under insider trading laws. This issue is further complicated when a consortium of private equity sponsors is bidding for a public company and needs to be carefully considered;
- forming associations (such as voting arrangements) with existing shareholders must also be carefully managed so as not to prematurely give rise to disclosure obligations or restrict the bidder's ability to acquire pre-bid stakes;
- prior to announcing a transaction, a bidder needs to have a reasonable expectation that its funding will be in place in order to pay any cash consideration to shareholders. In order to deliver a higher degree of deal certainty it is common for bidders to arrange debt finance on a certain funds basis; and
- the involvement of management and the directors of a public target needs to be carefully managed so that management and the directors do not breach their duties and to ensure that the transaction does not constitute unacceptable circumstances. Public company boards can be very sensitive to management participation in any proposed buyout and the potential conflicts of interest that might arise (see question 3).

The ongoing requirements associated with an investment in an entity that remains listed include the following:

- complying with the continuous disclosure regime. Public companies must immediately disclose all material price sensitive information unless there is a relevant exemption (such as where the information is confidential, forms part of an incomplete proposal and a reasonable person would not expect it to be disclosed);
- obtaining shareholder approval for certain transactions (such as transactions involving related parties, issuing more than 15 per cent of share capital in any 12-month period or in certain circumstances changing the nature or scale of the business); and
- complying with principles of good corporate governance. The ASX provides recommendations of the corporate governance principles to be adopted by boards of listed entities; however, compliance with those principles is generally not mandated. A listed entity that does not satisfy the recommended principles must disclose the extent to which it does not comply and the reasons for its non-compliance. The corporate governance recommendations include a requirement that a majority of the directors be independent and that the chair of the audit committee be independent. Certain recommendations are mandatory for entities that are included in the S&P/ASX 300 Index.

Once taken private, there is greater freedom in terms of conducting corporate transactions, greater flexibility over the company's capital structure including increased flexibility to make cash distributions to holding companies, to service debt and significantly less onerous disclosure requirements.

Where a private equity sponsor seeks to exit its investment by taking the portfolio company public, some considerations will include the following:

- putting in place a capital structure that is appropriate for a listed entity. Generally, ASX-listed entities will have only one class of ordinary shares on issue, although performance rights and options are commonly used as part of management and director remuneration packages;
- the level of ownership and control that a sponsor might retain in the listed entity (if any) and any escrow restrictions that will apply to that holding; and
- the additional expense associated with complying with the ongoing requirements of a listed entity (as set out above).

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3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Target directors have fiduciary duties, and executive directors have duties as employees and specific contractual duties under their employment contracts. A conflict of interest will arise if directors cannot fulfil such duties or their interests do not align with those of the company (or its shareholders).

In public-to-private transactions, particularly where management will be retained and given the opportunity to participate in the ownership of the target by a private equity bidder, or where a director is also a significant shareholder, maintaining target board independence is vital. While there is no express duty on directors to actively conduct an auction process or otherwise seek the best price for a company, the directors must act in accordance with their general duties to act in the best interests of the company and to avoid conflicts of interest. Furthermore, the Takeovers Panel has jurisdiction to ensure that control transactions do not constitute unacceptable circumstances (which can occur where a transaction is not conducted in an efficient, competitive and informed market) and accordingly is concerned with ensuring that consideration of a bid by a target board and management is free from any influence from insiders. The Takeovers Panel has issued guidance on insider participation in control transactions and, while that guidance has broader application, it specifically notes that private equity buyouts frequently have features that make the guidance relevant to such transactions.

Some of the key considerations for the target's management and directors are as follows:

- when to notify the board of an approach from a potential bidder;
- when to disclose confidential due diligence information to a potential bidder;
- whether or not to provide equal access to information to a rival bidder;
- when management or directors should stand aside from negotiations; and
- when information concerning an approach should be disclosed to shareholders and how much information should be disclosed.

From a practical perspective, where there is potential participation from management or directors, target boards commonly adopt conflict protocols and establish an independent committee to oversee the consideration of the transaction and will generally appoint an independent financial adviser to assist in determining their recommendations.

Where a transaction involves a bidder that has a 30 per cent (or greater) stake in the target or where the target and bidder have common directors, the target board is required to obtain an independent expert report. In practice, many target boards are reluctant to make a recommendation without such a report.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

As noted above, public-to-private transactions require higher degrees of disclosure than acquisitions of private companies. The disclosure requirements for a takeover offer and a members' scheme of arrangement are broadly comparable and include details of the bidder's intentions, funding arrangements for cash consideration, prospectus-level disclosure concerning the bidder and the merged entity if the offer consideration includes securities and all information known to the bidder that is material to a target shareholder's decision of whether to accept the offer. A members' scheme of arrangement requires a report from an independent expert giving an opinion on the fairness of the scheme. A target board may choose to include a similar independent expert report in a target's statement in the context of a takeover offer.

If a bidder is given access to due diligence information, that fact is usually disclosed in the bidder's statement (for a takeover offer) or the explanatory memorandum (for a scheme). Where a bidder comes into possession of inside information in the course of due diligence, the prohibition on insider trading would generally prevent the bidder from acquiring securities until the information is made public or ceases to be material. In practice, the bidder's statement or explanatory memorandum would be used to disclose any potential inside information so as to release the bidder from that restriction.

Target boards are not obliged to provide equal access to information to rival bidders. Accordingly, in a takeover context the target board, provided that it acts in accordance with its fiduciary duties and in the best interests of the company, may choose what information it discloses and to whom.

In relation to public listed companies, bidders will be required to notify the market if they acquire an interest of 5 per cent or more or become associated with someone who has an interest of 5 per cent or more. Additional disclosure is required for any change to that interest of 1 per cent or more. Copies of agreements that 'contributed' to the change in the person's interest or that gave rise to the association are required to be disclosed.

Shareholdings of less than 5 per cent can also be discoverable where a listed company issues a tracing notice to its registered holders to require identification of any person that has an interest in or can give directions in respect of that holding. For this reason, equity derivatives are becoming increasingly popular as a way of accumulating economic exposure to the target stock (of less than 5 per cent) without risk of identification.

A listed target is required to immediately notify shareholders once a takeover has been launched. Under the continuous disclosure regime, a listed target would also be required to notify its shareholders once an agreement is reached with a bidder to conduct a scheme of arrangement.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Public-to-private transactions tend to involve 100 per cent of the target securities being acquired through either of the following:

- a takeover offer, subject to a 90 per cent minimum acceptance condition (in general, once the 90 per cent threshold is achieved, the bidder is able to compulsorily acquire the remaining shares); or
- a court-approved members' scheme of arrangement (this typically involves the target securities being transferred to the bidder, conditional on approval of the scheme by 75 per cent of shareholder votes cast on the resolution and a majority in number (50 per cent) of the shareholders present and voting (either in person or by proxy) on the resolution.

Certain transactions by foreign persons are subject to Australia's foreign investment regime. Broadly, the Treasurer has the power to block or unwind significant actions, or impose conditions on the way they are implemented, if he or she considers them to be contrary to the national interest. A subset of these transactions, called 'notifiable actions' must be notified to the Treasurer. Failure to notify is an offence under the law.

The process of notifying a transaction and obtaining a statement of no objection is known as obtaining 'FIRB approval'.

A foreign person includes any corporation, trust or partnership in which a foreign person (and its associates) has a 20 per cent interest, or foreign persons (and their associates) have an aggregate 40 per cent interest.

'Notifiable actions' include the following:

- acquisitions of 20 per cent or more in Australian entities valued above the monetary thresholds (currently A$261 million for most investors and A$1.134 billion for investors investing in non-sensitive businesses directly from certain treaty countries);
- acquisitions of 'direct interests' (generally, 10 per cent or more; or 5 per cent or more when coupled with certain kinds of arrangements; or transactions that result in the acquirer having influence, such as being able to appoint a director) in Australian agribusinesses above the monetary thresholds (currently A$57 million investment value

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including prior holdings in the target, with different thresholds for certain treaty country investors);

- acquisitions of interests in Australian land above the monetary thresholds (which differ depending on the type of land and the nature of the acquirer, and can be nil);
- acquisitions of 5 per cent or more in an Australian media business;
- certain transactions by foreign government investors, including:
  - acquisitions of 'direct interests' (defined above) or interests in land by foreign government investors (importantly, this can capture acquisitions of securities in non-Australian companies unless the Australian assets of the non-Australian company are insignificant);
  - a foreign government investor starting a new business in Australia; or
  - acquiring a legal or equitable interest in a tenement or an interest of at least 10 per cent in securities in a mining, production or exploration entity (ie, an entity where the total value of legal or equitable interests in tenements held by the entity, or any subsidiary of the entity, exceeds 50 per cent of the total asset value for the entity).

Foreign government investors include entities that are owned 20 per cent or more by foreign governments or their agencies, such as sovereign wealth funds, state owned enterprises and statutory public sector pension funds (including where such entities are limited partners in a private equity fund). Many private equity funds have significant participation by sovereign wealth funds and statutory public sector pension funds that can cause the fund and any entities it has invested in to be characterised as foreign government investors. Careful consideration should be given to the fund structure and whether or not the private equity investor is classified as a foreign government investor for Australian foreign investment purposes.

Significant actions that are not notifiable actions capture a broad range of change of control-type transactions not listed above, but most importantly include the following:

- acquisitions of the assets of an Australian business; and
- acquisitions of offshore targets that have the requisite connection to Australia (currently, where the offshore target has Australian assets valued above A$261 million).

Australia also has an antitrust regime, regulated by the Australian Competition and Consumer Commission (ACCC), which aims to ensure that mergers and acquisitions activity in Australia does not result in a substantial lessening of competition.

Takeover offers typically take a minimum of three to four months from announcement to completion. Once the takeover is announced, the sponsor would need to seek the relevant regulatory approvals (such as FIRB or ACCC); prepare and lodge the 'bidder's statement' (being both the principal statutory filing for the bidder and the offer document, which is mailed to target shareholders); and open the offer period (which must be for a minimum of 30 days; however, in order to obtain the desired level of acceptances from shareholders, the offer period is often extended). Takeover bids commonly contain minimum acceptance conditions to ensure the bidder achieves the desired level of ownership. A 90 per cent minimum acceptance condition is the most common condition as this is the required threshold for the bidder (provided certain other conditions are met) to compulsorily acquire any outstanding shares on issue. A 50 per cent minimum acceptance condition can be used where the bidder is looking to achieve a controlling interest.

As schemes of arrangement are put to shareholders by the target, not the bidder, they can generally only be undertaken when the acquisition is friendly. The notice of meeting and explanatory memorandum for the scheme are prepared by the target. Two court hearings are involved: the first to approve the notice of meeting and explanatory memorandum and to make orders for the target to convene the shareholders' meeting, and the second to approve the scheme itself after its approval at the shareholders' meeting. While there is significant lead time in preparing documentation prior to the initial court approval, in general schemes take approximately the same length of time to implement as takeover offers.

Because schemes of arrangement provide certainty to bidders of obtaining 100 per cent of the target's securities (if approved) while imposing a 75 per cent approval threshold, most public-to-privates in Australia occur by way of a scheme of arrangement.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

As described in questions 2 and 5, public to private transactions in Australia are usually conducted by way of a takeover offer or members' scheme of arrangement.

In relation to a takeover offer, shareholders can object to a transaction by electing not to tender their shares into the offer. A bidder can compulsorily acquire a dissenting shareholder's shares if the bidder and its associates have relevant interests in 90 per cent of the securities in the bid class and the bidder and its associates have acquired at least 75 per cent of the securities that the bidder offered to acquire under the bid (whether the acquisitions occurred under the bid or otherwise). Accordingly, a 10 per cent shareholding can operate as a blocking stake to a 100 per cent acquisition under a takeover offer. In relation to a members' scheme of arrangement, the scheme must be approved by 75 per cent of shareholder votes cast and a majority in number (50 per cent) of the shareholders present and voting (either in person or by proxy). The size of blocking stake required under a scheme of arrangement is therefore dependant on the level of voting participation. Voting participation for resolutions relating to change of control transactions in Australia has traditionally been approximately 62–65 per cent, however it has also been significantly higher and lower in some transactions. Given average voting levels of 65 per cent it is generally considered that a 15 per cent stake could act as a blocking stake on a scheme vote.

Bidders can require the target to obtain a public statement from a major shareholder that it intends to accept the takeover offer or that it intends to vote in favour of the scheme in the absence of a superior offer (as applicable). Public statements of intention in connection with a control transaction are binding under Australia's 'truth in takeovers' policy unless clearly qualified. This gives the bidder comfort that it has the support of one or more major shareholders. Such arrangements need to be carefully structured and implemented so as not to create an association or other arrangement between a bidder and shareholder that would breach the takeovers laws or that would impact voting classes in a scheme.

Bidders sometimes look to increase their chances of success by obtaining a pre-bid stake. While such a shareholding counts towards the 90 per cent threshold in a takeover and can act as a blocking stake against a rival bid, a bidder's shares cannot be voted on the scheme.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Private equity buyers typically seek comprehensive warranties, indemnities and post-completion price adjustments. They also commonly seek conditions precedent for regulatory approvals such as FIRB approval and ACCC clearance, and in private transactions can also include a condition precedent for financing.

Competitive auction processes have been employed by sellers to create competitive tension, encouraging a 'take it or leave it' approach where agreements are unconditional or contain very limited conditionality.

Private equity sellers typically seek a 'clean exit' (to facilitate repatriation of returns to investors on exit, rather than at the expiry of the claim periods or the satisfaction of escrow conditions) and provide only limited warranty protection, with typically short claim periods and no guarantees or post-completion covenants. On exit, third-party purchasers are typically required to obtain comfort from management warranties and their own due diligence (although there is a common practice of providing vendor due diligence that is capable of reliance). It is becoming increasingly common in private transactions for either the buyer or the seller to obtain warranty and indemnity insurance (buy-side policies are more common). The insurance operates to effectively protect both parties from loss from a claim under a warranty or indemnity (to the extent it is not a known risk at the time).

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In public-to-privates, a merger or scheme implementation agreement will normally be entered into between the bidder and target. The agreement will govern conduct of the bid. It is common to extract a break fee from the target of up to 1 per cent of its market capitalisation or equity value, together with 'no-shop' and 'no-talk' undertakings, the latter being subject to the directors' fiduciary duties to facilitate a superior offer. Reverse break fees are also becoming increasingly common.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

Management typically participate in private equity transactions by acquiring ordinary non-voting shares (or their equivalent) in the bidding vehicle, which may have special rights to returns (known as ratchet rights) and that are subject to extensive transfer restrictions and drag-along rights in favour of the private equity investor to assist it in achieving an orderly exit.

If management already hold equity in the target, they are commonly given shares in the bidding vehicle in exchange for their shares in the target, structured typically to obtain 'rollover relief' to defer taxes otherwise imposed on any gains from the exchange.

Shares (and rights to acquire shares) issued to management as part of an employee share scheme are generally subject to tax in the hands of the recipients. These shares (and rights to acquire shares) may be eligible for concessions or it may be possible to defer tax liability by carefully structuring the terms of these securities. A key consideration for management is whether any gains are taxed as income or more concessionally taxed as capital gains.

Participation by management in bidding vehicles gives rise to conflicts of interest for management. These are typically addressed through adherence to strict management protocols (which require directors with conflicts to excuse themselves from deliberations concerning the proposal and in making any recommendation to shareholders) (see question 3).

In takeovers and schemes of arrangement, management deals can create 'association' issues for bidders. Full disclosure of the arrangements may be required in the bidder's statement or scheme booklet. In the case of a takeover, if benefits are given during the takeover offer period (and are therefore likely to induce the manager to accept the offer) they risk being collateral benefits that are prohibited under the Corporations Act. Finally, any arrangements made to acquire or an agreement to acquire any target shares (including management's target shares) during the four-month period prior to the bid will set a minimum floor price for the offer.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Direct taxation issues

The main direct tax issues relate to financing the acquisition (where the bidder is an Australian company) and exit strategy. For interest expenses to be deductible, borrowings (generally including subordinated debt) are required to be used for income producing purposes. Preference shares and other equity interests issued by a bidder may also qualify as 'debt' for tax purposes (depending on the terms), in which case dividends paid or accruing on such shares may be deductible. Interest expenses incurred by the bidder cannot be set off against the target's net income for tax purposes unless the bidder and the target are part of the same tax consolidated group. This requires the bidder to acquire all the shares in the target and be an Australian resident company for income tax purposes.

In many instances, such as where the bidder is controlled by non-residents or where the target has overseas subsidiaries, the level of 'debt' financing must satisfy 'thin capitalisation' rules (which limit deductions for excessive 'debt' funding). A safe harbour is permitted for interest-bearing debt up to 60 per cent of the difference between assets and other non-interest bearing liabilities (approximating a debt to equity ratio of 1.5:1). More generous thin capitalisation limits apply for banks and other financiers. An arm's-length debt test and a worldwide gearing test may allow a greater level of debt. Transfer pricing rules may also be relevant in determining allowable levels of debt.

Generally, interest and dividends (subject to certain exceptions) paid or credited to non-residents are subject to withholding taxes. There are some limited exceptions to the payment of withholding taxes on interest where certain qualifying debt instruments or syndicated loan facilities are publicly offered or under certain tax treaties where the loans are made by certain qualifying banks.

Gains made by private equity funds and their investors are typically considered to be on revenue account (rather than capital account) where the relevant fund or investor intends to make a profit from the sale of the investment (rather than by holding the investment and deriving regular income). Where the fund or investor is a non-resident, Australia will tax that gain if it has an Australian source and is not prevented from doing so under an applicable treaty.

Where the gain is considered to be on capital account (for example, where some deeming rules operate in respect of specific private equity fund structures or in the case of non-private equity investors), non-resident investors are exempt from tax on gains made on a disposal unless the gain is referable predominantly to Australian land interests.

The Australian Taxation Office (ATO) has expressed its views on some of these issues, including the following:

- that gains made by foreign private equity entities can in particular circumstances (which are likely to apply to most private equity structures) be treated as ordinary income (and are not eligible for the non-resident capital gains tax exemption) and are therefore taxable in Australia where those profits have an Australian source;
- anti-avoidance provisions can apply to common foreign investment structures where interposed entities are used to access the benefits of Australia's treaty network (namely, treaty shopping);
- a 'safe harbour' is provided for foreign investors investing into Australia through foreign limited liability partnerships in particular circumstances where those foreign investors are able to access relevant tax treaty benefits; and
- the source of gains made by a private equity fund will not depend solely on where the purchase and sale contracts are executed (that is, regard will be had to the place in which the relevant entity operates, the location of its central management and control and from where it derives its profits).

If a non-resident disposes of certain interests (including shares in a company or units in a trust), the value of which is predominantly derived from Australian land, the purchaser will be obliged to withhold and remit to the ATO 12.5 per cent of the proceeds from the sale. It should be noted that not only will this withholding apply to the taxation of capital gains, it will also apply where the disposal of the relevant asset is likely to generate gains on revenue account, and therefore be taxable as ordinary income rather than as a capital gain. This withholding is not levied as a 'final' withholding tax.

Where a transaction by a foreign person is notifiable to FIRB, it is not unusual to have tax conditions imposed on the transaction to ensure compliance with tax laws. The ATO uses this process to obtain additional information on tax matters associated with the transaction and any existing investments.

The tax consolidation rules treat entity acquisitions as if they were acquisitions of the underlying assets. Opportunities exist to achieve a 'step-up' in the cost base of various assets for income tax purposes if all the equity in a target is acquired by a bidder that is an Australian resident company and that is part of a tax consolidated group or that subsequently makes an election to consolidate. However, 'step-downs' in tax bases can also occur (eg, if acquired asset values have declined since the last acquisition occurred). Whether this step-up or step-down has a material impact on the tax profile will depend on the type of assets that are affected.

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Under the tax consolidation rules, where the deemed purchase cost is allocated to inventory, this would shelter future gains on sales of that inventory from tax. Likewise, where it is allocated to depreciable assets (eg, equipment), this would have the effect of increasing deductions for depreciation charges. Amortisation of goodwill is not deductible for Australian income tax purposes.

Indirect taxation issues
The main indirect tax issues relate to stamp duty and goods and services tax (GST).

Stamp duty
With respect to stamp duty, there are three heads of duty that generally apply in the context of private equity transactions:
- landholder duty – for dealings in shares and units, including share/unit purchases and share/unit subscriptions;
- private unit trust duty – for dealings in units only; and
- transfer duty – for asset purchases.

Landholder duty
Acquisitions of 'significant interests' in an Australian or foreign entity that holds, directly or indirectly, land interests in Australia above a particular threshold (ie, is a 'landholder') are subject to landholder duty in the relevant Australian jurisdiction. The significant interest and landholding thresholds vary from jurisdiction to jurisdiction, depending additionally on whether the target entity is listed or unlisted, but generally a significant interest is a 50 per cent or greater interest for acquisitions in unlisted entities and a 90 per cent or greater interest for acquisitions in listed entities, and the landholding threshold ranges from A$0 to A$2 million. Please note that land interests are also varyingly defined in broad terms, and can include things attached to the land regardless of whether they constitute fixtures at common law.

Private unit trust duty
Acquisitions of any units in an unlisted trust that holds, directly or indirectly, 'dutiable property' (as varyingly defined and outlined below) in Queensland or South Australia irrespective of the percentage threshold, may be subject to private unit trust duty in those jurisdictions. This head of duty is scheduled to be abolished in South Australia with effect from 1 July 2018; however, there is a risk that its abolition may be postponed.

Transfer duty
Transfers and (for most jurisdictions) agreements for the transfer of dutiable property are subject to transfer duty in the relevant Australian jurisdiction. Dutiable property is varyingly defined, but generally includes land interests and may further non-exhaustively include intangibles (such as goodwill and intellectual property), plant and equipment, trading stock and trade debts.

Foreign purchasers
Please also note that, in addition to the heads of stamp duty discussed above, certain Australian jurisdictions have begun, or are scheduled to begin, imposing a stamp duty surcharge on share, unit and asset acquisitions by 'foreign purchasers'. A foreign purchaser is varyingly defined but broadly is in accordance with the definition of 'foreign person' for the purposes of FIRB approval as discussed in question 5.

GST
With respect to GST, supplies of goods or services made by entities that are registered for GST generally attract GST (similar to value added tax) subject to the discussion below. GST is imposed at the flat rate of 10 per cent and, under the GST law, is a liability of the supplier, but is typically passed on to the recipient. However, in the context of private equity transactions, the following GST treatment may apply:
- 'input taxed supplies' for dealings in shares/units: where the supply is an acquisition of an interest in or under shares/units, that supply is input taxed such that no GST will be payable on it. However, the supplier and recipient may not be able to recover the GST costs (in the form of input tax credits) associated with that supply and acquisition respectively; and
- 'GST-free supply of a going concern concession' for asset purchases: where the assets are acquired as part of a going concern (in effect, a continuing business), that supply is GST-free, such that no GST will be payable on it. However, unlike input taxed supplies, the supplier of a GST-free supply is entitled to recover the input tax credits associated with that supply. Please note that if this concession does not apply, the asset purchase may give rise to a taxable supply that is subject to GST.

General anti-avoidance issues
It should also be noted that Australia has very far-reaching anti-avoidance rules in the context of both direct and indirect taxes, including multinational anti-avoidance law and diverted profits tax directed at multinational corporations and general anti-avoidance provisions. Accordingly, all transactions need to be considered in the context of the risk posed by those rules.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Senior secured debt and mezzanine (or subordinated) debt are the most common forms of debt funding for private equity transactions. More recently, however, leveraged transactions are being financed by institutions (rather than banks) adopting a 'uni-tranche' structure that essentially combines senior and mezzanine debt into one loan rather than keeping them separate. Initial debt financing was traditionally limited to a small number of lenders who underwrote the bank debt, with syndication occurring post-funding. Following the credit crisis, it became more expensive for private equity sponsors to obtain underwriting for large parcels of debt and banks have insisted on the inclusion of market flex clauses. As a result, some private equity sponsors have brokered their own debt syndicates and signed up the full syndicate of banks for initial funding. In almost all of Australia's recent private equity public-to-private transactions, this is how the financial sponsors have arranged their debt finance. Private equity transactions occasionally utilise bridge loans to fund the acquisition, which are then replaced by US-based high-yield debt securities or retail debt securities such as notes that are exchangeable into shares on IPO at a discount to the offer price.

It is common for financing arrangements to contain a provision that enables banks to require the repayment of outstanding liabilities on a change of control. In general, existing indebtedness of a target company or group is often repaid as part of the change of control with the bidder having new debt facilities form part of the acquisition funding.

Australia has financial assistance prohibitions that restrict a target company from financially assisting someone to acquire its shares (or the shares of its holding company), unless shareholders approve the assistance. Financial assistance includes the target or its subsidiaries giving guarantees or granting security in favour of a financier who is providing acquisition funding to a bidder. Further information regarding financial assistance is set out in question 12.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Bidders must have a reasonable basis for concluding that sufficient funding (debt and equity) will be available for the bid.

Equity funding commitments of private equity investors are typically set out in equity commitment letters addressed to the target, which represent that the fund has sufficient equity to meet the bidder's obligations under the transaction documents and commit to drawing down the funds from investors subject to satisfaction of any conditions precedent in the transaction documents. Disclosure of equity funding commitments is required in the bidder's statement (or scheme booklet).

Although not specifically required by law, intense competition for quality targets and the increasing sophistication of lenders has led to

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debt funding structures containing 'certain funds' provisions (consistent with practice in, for example, the United Kingdom). This involves financing packages containing conditions that are limited to fundamental defaults, such as insolvency. This is a higher threshold than the 'reasonable basis' requirement referred to above.

The debt financing package is usually set out in a debt commitment letter and detailed term sheets, which are then replaced with definitive financing documents if the bid is successful.

In recent leveraged transactions, the terms of the debt facilities have included provisions that specifically provide for equity cures and clean-up periods to allow sponsors to support investments that may otherwise be in default given the limited due diligence that can be conducted pre-bid.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

The nearest equivalents under the Corporations Act are as follows:

- 'uncommercial transactions': broadly, any transaction a reasonable person would not have entered into having regard to the benefits and detriments to the company and the respective benefits to other parties of entering into the transaction. If such a transaction causes insolvency, the transaction may be voidable at the instigation of the liquidator appointed. Similar provisions exist in relation to 'unfair loans' and 'unreasonable director-related transactions'. These are only a potential issue should the company formally enter into liquidation (as opposed to receivership, administration or a creditors' scheme of arrangement);
- 'unfair preference': broadly, if security is granted to a party that was previously an unsecured creditor and is not providing new money, that transaction may, in the event of liquidation, be set aside at the instigation of the liquidator (ie, be voidable as the transaction would result in the creditor receiving a preferred distribution vis-à-vis other unsecured creditors in a winding up). The look-back period is generally six months, although if the transaction was between related parties the look-back period is four years. Similarly to 'uncommercial transactions' this is only a potential issue should the company formally enter into liquidation (as opposed to receivership, administration or entry into a scheme of arrangement); and
- 'financial assistance': whereby a company financially assists another to acquire shares in itself or a holding company. Issues associated with financial assistance typically arise in connection with the grant of security by a target company over its assets to the bidding company for no direct consideration. Notably, a contravention of the financial assistance provisions does not automatically affect the validity of the transaction, but any person involved in the contravention would be guilty of an offence. The court, however, has the power to make orders that would have the commercial effect of unwinding the transaction.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Where a private equity investor takes a minority interest or where there are two or more private equity investors, protections sought by private equity investors typically focus on retaining control over key operational and corporate decisions during the term of the investment, regulation of share transfers and exit procedures. Negative control (or veto rights) over the operation of the business is a fundamental requirement to give minority shareholders a say in determining the direction of the business. Consent rights in relation to certain corporate actions (for example, blocking a potentially dilutive issue of shares) and key operational matters (for example, approving budgets and business plans, dividends, acquisitions and disposals) are also typically included. Director appointment rights, quorum requirements and periodic receipt of information (particularly financial information) are also important.

Pre-emption rights on transfer, tag-along rights and drag-along rights are standard, as are exit mechanics (IPO, trade sale or secondary buyout). Good leaver and bad leaver provisions for management are also usual (with bad leavers forced to sell at the lower of fair market value and cost, and good leavers at fair market value).

Covenants not to compete with the business or poach staff for a period (generally one to three years) are also common. However, the term and geographic scope of the restraints must be reasonable or such covenants risk being unenforceable.

Generally, the protections for minority shareholders will be contained in the shareholders agreement and will be negotiated at the outset of the investment. These can include approvals required for further issues of securities or fundamental changes to the business or scale of the business.

There are statutory approval requirements (usually a 75 per cent voting threshold) for a number of corporate actions, but for a private company these are subject to the company's constitution and the requirements can in some cases be amended or removed. Often minority stakes are not of a sufficient size to impact the outcome of votes such that most of the powers will rest with the majority shareholder or private equity investor.

Where a member holds a different class of shares from the majority (for example, non-voting preference shares) then corporate actions affecting the rights attaching to that class are subject to a separate vote. Accordingly, the majority holder of ordinary voting shares cannot strip rights from preference shares without a separate vote of the holders of preference shares.

The statutory protection for minority shareholders is otherwise very limited. There is a prohibition under the Corporations Act of 'oppressive conduct', which includes unfairly prejudicial or discriminatory conduct against one or more minority members. Minority members (or ex-members, where the impugned conduct has led to their removal from the members' register) have standing to seek relief under the statute and there are a wide range of remedies available. In practice, however, statutory oppressive conduct actions are rare and unlikely to succeed.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Question 2 sets out the key requirements. In particular, a person or entity cannot acquire 20 per cent or more of a public or listed company without making a formal takeover offer for the relevant company unless a specific exception is available such as where the target conducts a members' approved scheme of arrangement. There are a number of prescribed requirements for a takeover offer or scheme that are set out in question 2 and other questions above. This is the major restriction on the ability to acquire control of a public company.

There is no equivalent requirement or restriction in respect of private companies in Australia.

There are minimum capitalisation requirements in Australia, which are outlined in question 9.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

There are no specific legal restrictions on how a private equity firm conducts a sale process on exit of a portfolio company. Consent requirements relating to minority shareholders (if any) are typically addressed in a shareholders' agreement via tag-along and drag-along rights. Private equity firms often conduct a 'dual track' exit process, which involves simultaneously running a private treaty sale process and undertaking preparations for an IPO. The value of these processes is dependent on market conditions. Given the recent resurgence in equity markets in Australia, the use of the dual track process has increased.

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Update and trends

The overhaul of Australia's foreign investment legislation had a major impact on private equity transactions. One effect of the amendments was that many private equity funds (and their portfolio entities) were deemed to be foreign government investors owing to passive upstream ownership by public sector pension funds. This meant they had to seek FIRB approval for virtually every deal done in Australia, which put a large time and cost burden on private equity funds. After extensive consultations with the industry, a new business exemption certificate regime was introduced that aims to alleviate this burden by giving a PE fund the ability to apply in advance in a single application for approval for a range of transactions it may undertake. It remains to be seen whether applicants are able to obtain suitable relief.

As with all IPOs, in the Australian context, there is a high level of disclosure required in order to offer shares in connection with a listing, particularly when offering to retail shareholders. Misleading statements or omissions of required information attract statutory liability with substantial penalties. The statutory liability extends to various individuals and entities involved in the listing or the preparation of the prospectus (including deemed personal liability for current or proposed directors) and this liability cannot be contracted out of.

In a private treaty sale of a portfolio company, private equity firms will usually seek to limit their ongoing or post completion liability in the manner described in question 7. Where a private equity firm sells a portfolio company to another private equity firm, this will directly conflict with the incoming buyer's desire for extensive warranties and indemnities outlined in question 7.

As referred to in question 7, it is now common for a private equity purchaser or vendor to use warranty insurance to address post-closing liability.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Where a private equity firm wishes to conduct an IPO in respect of a portfolio company, the existing shareholders' agreement will be terminated. Once listed, the operations of the company will be governed by the ASX Listing Rules. Both as a matter of market practice and under Australian law and the ASX Listing Rules, most terms in shareholders' agreements such as vetoes over board decisions, pre-emption rights, drag-along and tag-along rights cannot be carried forward post listing as they are generally not permitted. Where a private equity investor retains a significant stake post listing it is possible to have a relationship agreement that covers rights such as information sharing and board nominations.

An IPO can only be conducted in Australia through an offering document or prospectus that is lodged with the Australian corporate regulator (the Australian Securities and Investments Commission). The offering document must contain prescribed information including all material information relevant to the business and prospects of the company. Often IPOs in Australia are conducted in conjunction with a non-registered 144A or Reg S offering in the US or jurisdictions in other parts of the world.

In the past, private equity firms exiting a portfolio company through an IPO have been able to divest their entire shareholding however it is now very common to see private equity firms retaining a substantial stake in the portfolio company post-IPO and be subject to a 'lock-up' or escrow of 12 to 24 months (depending on the forecast period included in the prospectus) for its retained shareholding.

The private equity sponsors may dispose of their stock following the release of any escrow through on-market sales or more commonly in an off-market sale known as a 'block trade'. Usually, the stock is offered, after market close and prior to market open to institutional investors at a discount to the current trading price. This is designed to minimise the uncertainty and delay and therefore the potential price impact that may result from selling, or attempting to sell, large holdings of shares on market. Where the selling shareholder is a 'controller' of the company, the block trade must be conducted with disclosure in the form of a 'cleansing statement' lodged by both the controller and the listed company (being disclosure of any material information known to the controller or the company) otherwise restrictions will apply to restrict the on-sale of shares for a period of 12 months.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Historically, investments favoured included those in the retail, manufacturing, building products, mining services, consumer products and industrial sectors that have strong cash flows. In recent years, real estate, healthcare, education, aged care and retail have also become targets of private equity transactions.

Further layers of regulation in addition to the Corporations Act, FIRB approval and Australia's antitrust legislation may apply to specific companies or industries. Such legislation may be enacted by state or commonwealth legislatures and may be specific to the target or regulate the industry in which the target operates. Restrictions generally only arise for companies that are in sensitive sectors such as the media (Broadcasting Services Act 1992 (Cth)), banking (Banking Act 1959 (Cth)), finance (Financial Sector Shareholdings Act 1998 (Cth)), aviation (Airports Act 1996 (Cth)) and health (various health legislation enacted by states and territories), or are subject to close regulation concerning privacy (such as casinos). Companies such as Qantas are regulated by their own acts of parliament (eg, Qantas Sale Act 1992 (Cth)). Some of these industries impose absolute limits on the level of foreign ownership of companies in those industries, such as the Airports Act, which limits foreign ownership of airport operators to an aggregate of 49 per cent. An acquisition of 5 per cent or more in the media sector requires prior FIRB approval.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Structuring is a critical influence on the tax outcomes in private equity transactions. Some of the areas that need to be addressed are as follows:

- the jurisdictional location of the bid vehicle will impact on the ability to gear the Australian operations; will impact on the ability to reset the tax bases of the target's assets; and may impact on the manner and efficiency of an exit;
- the level of debt that can be used under the Australian thin capitalisation provisions (see question 9);
- whether the debt can be structured so as to satisfy the 'section 128F' public offer exemption or to avail itself of treaty relief, to enable interest on facilities to be paid to non-residents free of withholding taxes; and
- whether any limitations exist on the ability to stream earnings within or out of the target group, as well as the ability to incur debt at various levels of the target group.

Foreign investment restrictions also apply to cross-border transactions and are set out in question 5.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Where more than one private equity firm invests in a target, an investment agreement or shareholders' agreement is entered into to set out the rights and relationship between investors. The arrangements principally relate to the following:

- board appointment and removal rights;
- the allocation of voting rights among sponsors and the mechanics for exercising voting control;

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- matters reserved for board or shareholder decisions (and whether veto rights exist) as well as delegated authority levels;
- access to information by shareholders and disclosure by board nominees of confidential information received through their role as director to those appointing them;
- future funding commitments, if any, and anti-dilution protections;
- exit mechanisms, including forced IPO or security sales, drag-alongs, tag-alongs, rights of first offer or refusal;
- competitive restraints or preferred vehicle rights for corporate opportunities;
- restrictions on related-party dealings and approval mechanisms;
- dispute resolution or 'deadlock' mechanics; and
- consequences of default.

One issue that has sparked some controversy is the manner and basis on which funding commitments are sought and specifically circumstances where financiers are tied exclusively to one bidder or bidding consortium. Target boards have in some instances sought, as a condition to granting access to due diligence information, to limit exclusive arrangements between a bidder and potential financiers.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Certainty of closing is becoming more and more important to securing target board support, particularly in a public company transaction. A target board is generally unwilling to support a transaction unless it has good prospects of completing. As such, buyers are forced to assume greater deal risk (by having fewer conditions) and banks are often required to commit funding on a certain funds basis. Private equity sponsors have in some cases agreed to pay reverse break fees where they breach their obligations under the transaction documentation to demonstrate their commitment to the deal, particularly where the transaction is subject to conditions.

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Austria

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Austria has seen the full spectrum of private equity transactions, from seed and growth capital to buyout transactions. Auctions have become quite unpopular with a lot of funds because of fierce competition. (Negotiated deals, on the other hand, typically involve a large amount of management time.) On the debt side, dedicated debt funds are becoming more and more active in Austria, most of them focusing on the term loan in an LBO (with a commercial bank typically providing the working capital facility for the target) or standalone growth capital debt financings (with or without equity kicker). Non-performing-loan transactions (that is, the purchase of secured and unsecured loans by a private equity fund from a financial institution aiming to restructure its balance sheet) and 'loan to own' transactions (that is, where a private equity fund acquires (often shareholder) debt or grants a loan with the ultimate aim to convert that debt into equity (which can either be through a contractual mechanism (for example, under a convertible loan or note) or forced in the course of a restructuring) have become less frequent.

In a typical equity transaction, the private equity fund will acquire the shares or business through a special purpose vehicle (SPV), which is funded by a combination of equity (provided by the private equity fund and sometimes management) and debt (provided by the financing banks or a debt fund). Debt transactions are structured similarly to bank lending transactions, with rather limited specifics on growth capital deals and complexities related to intercreditor issues on LBO deals.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The level of regulation for a joint stock company (JSC) is greater than for a LLC or a partnership (eg, a JSC is subject to stricter rules on corporate governance and accounting) and again increases if the JSC is listed (eg, a JSC that is listed on the Prime Market of the Vienna Stock Exchange is subject to disclosure and reporting regulations of the Code of Corporate Governance, some of which are mandatory, others require the issuer to 'comply or explain' and others are recommendations only). For that reason, private equity firms will typically seek to take a listed target private to benefit from reduced regulation as well as reduced costs. Further, it should be noted that changes to the management board and supervisory board of a (listed) JSC are more difficult and time-consuming to implement than in the case of an LLC.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

As a general rule, the management board of a JSC is required to promote the interests of the company, considering the interests of its shareholders, employees and other stakeholders. Where the JSC is listed, the management board must also take measures to prevent market manipulation and insider trading and must not make any inaccurate public statements. Additional obligations apply whenever a takeover bid is involved. Most importantly, they are prohibited from taking measures that could prevent the shareholders of the JSC from taking a free and informed decision with respect to the takeover bid, and they must seek the approval of the shareholders' meeting prior to implementing measures that could frustrate an announced takeover bid. The solicitation of a competing bid, however, is specifically allowed.

Where members of the management board or the supervisory board are participating in a transaction (see question 8) or otherwise have an interest in a transaction, they have to notify the company accordingly and will generally not be permitted to vote with respect to the transaction or to participate in associated meetings. In addition, where the transaction involves a takeover bid, the relevant member of the management board or supervisory board must not participate in the preparation of the statement on the takeover bid (which is required to be issued by the management board and supervisory board following announcement of the takeover bid under the Takeover Act).

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The disclosure requirements in connection with going-private transactions differ depending on the transaction structure applied. The usual going-private transaction involves a voluntary takeover bid aimed at control conditional upon the acceptance of 90 per cent of the outstanding share capital followed by a delisting. There is no delisting by application to the Securities Commission. Rather the delisting is the consequence of certain types of squeeze-out transactions and reorganisations. The most common ways to achieve a delisting are a squeeze-out of the minority shareholders pursuant to the Shareholders Exclusion Act. In specific situations reorganisations may also be an option (eg, merging the business of a public company into a non-listed company or transferring the business of a public company to its main shareholder by way of a merging conversion) and may yield certain benefits compared with the normal route of a squeeze-out pursuant to the Shareholders Exclusion Act.

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There are enhanced disclosure requirements with respect to squeeze-outs, which differ from structure to structure but they are all aimed at protecting the interests of the minority shareholders, employees and creditors. The notification requirements in connection with the delisting itself differ depending on the market segment in which the securities concerned are trading. A ruling of the Securities Exchange Commission is not required.

In addition, a person directly or indirectly acquiring or disposing of shares (the scope is actually broader and includes various instruments such as options) of a public company admitted to trading on a regulated market is required to notify the target, the stock exchange and the Financial Market Authority if, as a result of such transaction, they reach, exceed or fall below a certain voting rights thresholds (4, 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 75 and 90 per cent of the votes; if the articles of association provide for it, the entry threshold is as low as 3 per cent) under the Stock Exchange Act.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The time required to complete a going-private transaction depends very much on the structure applied (see question 4). As a rough guideline, squeeze-outs generally take between two and three months. Reorganisations not involving a squeeze-out can sometimes be completed more quickly.

Other timing considerations that apply equally to public and private transactions include the time required for due diligence, the time required to obtain antitrust and regulatory clearance, or required third-party approvals, or to implement any agreed pre-closing restructuring. In addition, where an organised auction process is involved, timing will largely depend on the process. The usual time frame for transactions in Austria is three to six months.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

The rights of minority shareholders differ depending on the structure applied to achieve a delisting (see question 4). In structures involving a squeeze-out, minority shareholders cannot block the transaction. They sometimes however seek to challenge going-private transactions for breach of procedure and frequently request a review of the cash consideration offered for their shares by a court (ie, a fairness review). If the squeeze-out is implemented following a takeover bid pursuant to the Shareholders Exclusion Act and the shareholders' resolution on the squeeze-out is passed within three months of the lapse of the offer period, there is a rebuttable presumption that the consideration offered is adequate if it amounts to the highest consideration paid during the offer period. This presumption is not available for other structures. Where no squeeze-out is involved in a going-private transaction (eg, a merger of the business of a public company into an unlisted company), Austrian courts have so far not granted a cash-out right to minority shareholders.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Provisions specific to private equity transactions relate to the financing of the transaction (see questions 10 and 11), the scope of warranties (if on the sell side a private equity firm will typically not be willing to give business warranties but try to limit warranties to title and capacity – in such circumstances the purchaser will have to rely on its own due diligence and warranties of management) and limited recourse for breach of warranty or indemnification to amounts put in escrow at signing or recoverable from warranty and indemnity insurance (see question 15).

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In buyout transactions, the private equity firm often involves future management in the due diligence process and the financial modelling. Typically, management is offered the opportunity (and is sometimes even required) to acquire an interest in the target to ensure management's commitment. Senior management is sometimes also given the opportunity to invest in the very same instrument ('institutional strip') acquired by the private equity firm, which ensures that the interests of senior management and the interests of the private equity firm are fully aligned.

In some cases, the incentive provides for a ratchet mechanism entitling management to an enhanced return once the return of the private equity firm exceeds a certain threshold. Where management is asked to participate in the institutional strip, options are by definition limited (although ratchet arrangements and the like are still possible). Where asked (or given the opportunity) to participate on target level, share options (in case of JSCs), restricted stock (for a description, see below), profit participation rights (that is a contractual arrangement that can be structured either as equity or debt and by contrast to shares never carries voting rights) and phantom stock (that is a contractual arrangement giving the member a bonus depending on operational performance) are the most common forms. The detailed structuring of the incentive packages is dependent on the tax treatment of the benefits in the relevant jurisdictions. For example, management will have a strong interest to ensure that any gains are taxed as capital gain and not as employment income. From a tax perspective, it is also important to ensure that upon the investment by the management members economic ownership actually transfers. Real shares are usually pooled and almost always restricted (restricted stock) by way of a restricted stock agreement or shareholders' agreement with the private equity firm. Such restrictions will typically include a right of the private equity firm to drag-along the shares of the management member upon an exit and compulsory transfer provisions if the employment with the target group terminates. The consideration due in the case of such compulsory transfer will often depend on the reason for termination ('good' and 'bad' leaver provisions), although owing to associated employment law issues the approach taken by private equity funds is much more conservative today than in the past.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Tax issues are crucial in private equity transactions. Investors regularly require that the acquisition of the target is structured in a tax efficient manner and that financing costs in relation to the acquisition in a target company may be offset against any profit resulting from it. Further, the distribution of dividends as well as tax considerations with respect to future exit strategies are typically decisive in choosing the acquisition vehicle with respect to Austrian and non-Austrian target companies.

Financing of an Austrian acquisition vehicle

Equity contributions into an Austrian corporation are no longer subject to capital duty. Since 1 January 2016, the previously applicable capital duty of 1 per cent has been abolished and, according to EU law, cannot be reintroduced. This has simplified funding structures as multi-tier structures (grandparent contributions) are no longer used to avoid capital duty.

Debt financed acquisitions should be structured carefully in order to secure the general deductibility of interest as well as the offsetting of such interest expenses from business profits of the target company. In

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general, interest expenses on loans from unrelated parties are fully tax deductible. The same holds true for interest paid to related parties, if the following criteria are fulfilled:

- the terms are at arm's length and properly documented;
- the debt is not requalified as equity; and
- there is no low taxation of group lenders.

With regard to the arm's-length test, the Austrian tax authorities generally apply the comparable uncontrolled price method. However, a comparison of inter-company financing transactions to those with commercial banks is generally not accepted by the Austrian tax authorities (because of differing objectives and goals of an unrelated lender, as well as the different risk profile). As a result, the interest rates of banks can only be considered as the upper limit of the arm's-length interest rate. In general, in determining the interest rate, factors such as currency, term, creditworthiness of the borrower and refinancing costs need to be taken into account. If the related-party lender has sufficient own liquidity, the tax authorities see the deposit interest rate as the appropriate interest rate for a related-party loan.

As to the requalification of debt into equity, it is worth noting that there are no statutory rules on thin capitalisation in Austria. From a practical perspective, tax authorities usually accept debt to equity ratios of around 3:1 to 4:1. Beyond that, interest deduction may be denied based on a requalification of shareholder loans into equity. Besides the non-deductibility, this would also result in the interest payments being treated as deemed dividends, which – unlike interest on shareholder loans – would be subject to withholding tax in Austria (see below).

Interest payments under a related-party loan of a foreign lender are not deductible in Austria if the interest payments are not taxed at an effective tax rate of at least 10 per cent at the level of the lender. According to the Austrian tax authorities, it is not relevant whether such low taxation is owing to the domestic law of the jurisdiction of the lender or the result of an applicable double taxation treaty.

Finally, it is worth noting that there is currently no interest barrier rule providing for a general limit on the deductible amount of interest expenses paid to unrelated parties. However, according to article 4 of Council Directive (EU) 2016/1164 (Anti-BEPS Directive), such limitation shall be implemented until 1 January 2024, at the latest.

Austrian group taxation regime

The use of an Austrian acquisition vehicle allows for the establishment of a tax group between the acquisition vehicle and the target. Such tax group allows for the offsetting of interest expenses at the level of the acquisition vehicle from business profits of the target.

The previously applicable goodwill amortisation regime on share deals (up to 50 per cent of the purchase price over a period of 15 years) is no longer available (it is only for acquisitions made by 28 February 2014).

In general, non-Austrian corporations may also be part of an Austrian tax group and their respective losses may reduce the Austrian tax burden. However, the group taxation regime was reformed in order to limit the inclusion of such non-Austrian subsidiaries (to corporations resident in EU member states or other countries with which Austria has concluded comprehensive administrative assistance procedures) and the attribution of their losses (which can only be offset by up to 75 per cent of the taxable income of such Austrian entities, with the balance being carried forward to future years).

Withholding tax

Dividends and interest payments are generally subject to withholding tax of 27.5 per cent. However, limitations and exemptions apply under domestic law as well as applicable tax treaties. In particular, withholding tax on dividend payments to non-Austrian investors is typically subject to the limitations under the EU Parent-Subsidiary-Directive and applicable double taxation treaties. Interest payments on loans to non-Austrian lenders are, in principle, no longer subject to withholding tax, as the previously applicable withholding tax in the case of loans that were secured by real estate located in Austria has been abolished.

Exit scenario

Private equity investors will usually seek a structure that allows for a tax-free exit. As there is no tax exemption for capital gains realised from the sale of shares in an Austrian company (as opposed to shares in a foreign company), foreign investors will now more often choose an acquisition vehicle in a foreign country with which Austria has concluded a double taxation treaty that provides that only such other jurisdiction is entitled to tax the capitals gains.

Further, it is worth noting that Austrian tax law provides for a sophisticated exit taxation regime under which capital gains taxation is – simplified – triggered under any circumstances that result in Austria losing its taxation right with respect to assets subject to taxation in Austria. However, if such taxing right is lost in relation to EU/EEC countries providing for comprehensive mutual assistance, the taxpayer may apply for payment of the exit tax in instalments over a period of up to seven years (unless the capital gain is actually triggered beforehand).

Real estate

For real estate deals a recent tax reform brought significant changes for companies owning Austrian real estate directly. First, the taxable event, 'unification of shares', that once required a unification of all shares in a company that directly owns Austrian real estate by one shareholder, now foresees a lower threshold of 95 per cent. Furthermore, shares held by trustees shall be attributable to the trustor in determining this and other similar thresholds. Second, if within five years in total 95 per cent or more interests in a partnership that directly owns real estate are transferred (also if in different transactions and to different purchasers), this now also triggers real estate transfer tax.

Management incentive packages

Management incentive packages usually take the form of share options, restricted stock, profit participation rights or phantom stock (see question 8).

An important aspect is whether, upon the investment by the management members, economic ownership in the shares (or other instruments) actually transfers. In relation to shares this mainly depends on the management members' entitlement to dividends (if any), voting rights and the applicability of transfer restrictions. From a tax perspective, management incentive packages are typically structured to ensure such transfer. In the case where economic ownership transfers and the management members receive the shares without paying an arm's-length consideration, the grant will be taxable as employment income at the fair market value of the shares received. Otherwise, the full return received at exit may be subject to taxation as employment income.

In the case of stock options, non-transferable stock options are not taxed at the time of the grant, but upon exercise of the option based on the difference between the (discounted) acquisition cost and the fair market value of the shares received based on the option. In contrast, transferable stock options are considered an asset for tax purposes and, consequently, are already taxed at the time of the grant.

Income from shares received by individuals resident in Austria is taxed at 27.5 per cent. Such income includes dividends as well as capital gains. Former models that granted shares to the management relied on an exemption for capital gains (if the percentage of the shareholding in the Austrian company was below 1 per cent and was held for more than one year) are no longer applicable as realised capital gains are generally subject to tax. However, in the case of non-resident individuals, capital gains are only subject to tax in Austria at a rate of 27.5 per cent if the percentage of the employee's (weighted) shareholding in the Austrian company amounts to at least 1 per cent during the previous five years. Double taxation treaties, however, usually restrict Austria's right to tax such capital gains (article 13, paragraph 5 of the OECD Model Tax Convention on Income and on Capital), whereas dividends are subject to withholding tax at a rate of 27.5 per cent (which is usually reduced by double taxation treaty).

Recurring income from profit participation rights that classify as equity at the level of the company is taxed similar to income from dividends, at a rate of 27.5 per cent. If, owing to its features, profit participation rights qualify as debt at the level of the company, income is taxed similar to interest at a rate of 27.5 per cent. Regarding the exit, profit participation rights generally give more room for a tax-optimised structuring than other incentives, such as stock options or restricted stock.

Income from phantom stock (not qualifying as profit participation rights) is generally taxed similar to ordinary income from employment at the progressive income tax rate.

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As well as the developments mentioned above, tax audits in relation to M&A deals are becoming more common and burdensome. In particular, transfer pricing issues, for example, in relation to interest on shareholder loans or certain fees payable to related entities, are under scrutiny. Accordingly, tax rulings are also becoming more popular.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Going-private and private equity transactions generally involve senior debt and, particularly for larger transactions, subordinated debt. Senior debt is typically provided by commercial banks or debt funds or a combination. Where a debt fund is involved, the debt fund typically underwrites the term loan facilities (to finance the acquisition and the costs of the acquisition) and the commercial banks the working capital facilities (to fund the working capital requirements of the target). More recently we have seen debt funds underwriting the entire package with a commercial bank in the back that provides the working capital facility. Vendor financing is also sometimes used. To meet 'certain funds' requirements in public-to-private transactions involving a takeover bid (see question 11), bridge financing is required, which more and more comes from debt funds as they have a quicker turnaround times than commercial banks. Where several layers of debt are involved, the private equity firm and financing banks will typically enter into an inter-creditor agreement that regulates the rights of each debt provider to receive payment and to realise the security.

The terms of the existing indebtedness often require prepayment upon a change of control and typically contain limits on additional leverage or dividend stoppers that will require a refinancing or renegotiation of the existing indebtedness. More often, existing indebtedness is prepaid, in which case prepayment notice requirements, prepayment fees, breakage costs and security releases will have to be considered by the private equity firm in the timing of the transaction.

Leveraged transactions typically involve upstream and sidestream security interests, guarantees and indemnities by the target group that are a concern under Austrian capital maintenance and, where a JSC is involved, Austrian financial assistance rules. Transactions violating Austrian capital maintenance rules are null and void as between the parties as well as any involved third party that knew or should have known of the violation. In addition, any members of the management or supervisory board who approved the transaction may be subject to liability for damages. Transactions violating Austrian financial assistance rules are not void, but may result in liability of the members of the management or supervisory board who approved the transaction. It is widely accepted to include limitation language in the financing documents to prevent liability and to ensure that security interests and guarantees will at least remain valid in part to preserve priority.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

As mentioned in question 4, a going-private transaction requires a takeover offer followed by a delisting. Under the Takeover Act, the private equity firm may only announce a takeover bid if it is certain that the funds necessary to pay the consideration in full are available (certain funds requirement); this must be confirmed in the opinion on the takeover bid of the independent expert, who is required to be appointed by a bidder under the Takeover Act. Unless a financing condition has been permitted by the Takeover Panel (which could be the case in a voluntary takeover bid not aimed at control), the independent expert will usually require a copy of the executed equity commitment letter from the private equity fund. Where the equity commitment letter only covers the equity portion of the purchase price, the independent expert will also want to see copies of the definitive finance agreements documenting the term loan facilities described in question 10 together with documents evidencing that all conditions precedent for drawdown of those facilities (other than those within the private equity firm's control) are satisfied.

Where a purchase agreement with one or more block shareholders is involved in a going-private transaction, the purchase agreement will typically include a condition that the acquisition vehicle will acquire the necessary number of shares in the takeover bid, so that it is able to proceed with the squeeze-out or reorganisation ultimately resulting in the delisting (see question 4)). Conversely, the seller in a private equity transaction will usually require a copy of the equity commitment letter from the private equity fund and copies of the definitive agreements documenting the term loan facilities (or at least a warranty that enforceable debt financing commitments have been obtained and obligations to ensure that definitive agreements will be in place by closing, failing which the purchaser will usually be required to pay the termination costs) to be sure that the acquisition vehicle will be able to pay the purchase price at completion of the transaction.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Under Austrian insolvency law, when an Austrian company has entered into insolvency proceedings, the administrator may challenge certain transactions if this challenge increases the prospects of recovery for the estate's creditors. Most notably, the administrator can challenge transactions aiming to discriminate against other creditors (if completed 10 years or less prior to the opening of the insolvency proceedings (if the counterparty was aware of that intent) or two years (if the counterparty should have been aware of that intent)), transactions for no value (if completed two years or less prior to the opening of insolvency proceedings), or the granting of security benefitting a creditor's debt or the settlement of a creditor's debt (if completed 60 days or less prior to the company becoming insolvent or the application for the opening of the insolvency proceedings). In leveraged transactions, there is a concern that security interests and guarantees can be set aside on such grounds. For that reason, purchase and debt-financing agreements typically include warranties that no insolvency proceedings are pending and that neither the target nor the seller is insolvent. Where, in a particular transaction, there is a concern regarding insolvency, the private equity firm will typically require additional evidence, such as an officer's certificate from the chief financial officer or a special audit opinion, or both, for assurance that there are no insolvency-related issues. In addition, actions taken with the intention to deprive other creditors of their rights may constitute a criminal offence.

Another concern related to leveraged transactions is personal civil or even criminal liability of members of the management board or supervisory board, or both, who approve upstream or side-stream security interests, guarantees, indemnities or similar commitments as these transactions may constitute a violation of Austrian capital maintenance or financial assistance rules (see question 10).

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements for a minority investment or a club deal involving investments made by two or more private equity firms will typically include provisions dealing with the following matters:

- composition of management board and supervisory board (if any);
- rights to nominate members or observers, or both, to the management board or supervisory board (if any);
- veto rights requiring the prior consent of the investor or an investor director (or the shareholders' meeting or the supervisory board with qualified majority);
- anti-dilution provisions (allowing the private equity fund to subscribe for nominal value in case any future round of investment is completed at a lower valuation);

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- liquidation preference (preferential treatment of the private equity fund upon exit);
- exit rights (right of the private equity fund to request initiation of a trade sale or an IPO process);
- a prohibition to sell for a certain minimum period (which may apply to all or only some of the shareholders, for example, the founders only, and may differ in length from shareholder to shareholder (lock-in)) and rights of first refusal, drag-along, tag-along and similar rights;
- requirements for management and annual accounts, business plan and budget;
- rights of access to information and management upon request; and
- covenants not to compete and not to solicit customers, suppliers and employees.

Statutory protection for minority shareholders differs. For corporations, minority shareholder protection includes information rights, rights to call a shareholders' meeting and minimum voting requirements for major measures (eg, corporate restructurings, changes of purpose, changes to articles of association, dealings involving substantially all of the business or assets and squeeze-out transactions). Some of these protections are mandatory, others may only be adjusted to the benefit of the minority shareholders and others can be amended without restriction.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

The acquisition of a controlling interest in a private company is not subject to any specific requirements other than as stated in question 18. In contrast, the acquisition of a controlling interest in a public company is subject to the Takeover Act, which requires notification of the acquisition to the Takeover Commission without delay and triggers a mandatory takeover bid for the remaining shares that must be launched within 20 trading days and is subject to, among other things, minimum pricing requirements, as follows:

- the consideration must not be lower than the highest price agreed or paid in the 12-month period before the announcement of the takeover bid; and
- the consideration must at least equal the average quoted share price (weighted according to trading volumes) in the six-month period before the day on which the intention to launch the takeover bid is announced).

The Takeover Act captures direct controlling interests (ie, where the bidder directly holds more than 30 per cent in a public company) and indirect controlling interests (ie, where the bidder holds a controlling interest in another public company that holds a controlling interest in the target or in a private company (or other entity) controlled by it, whether through shareholding or based on contract, that in turn holds a controlling interest in the target). There is, however, an exception: where the stake acquired by the bidder does not confer control on the bidder or the bidder already has control, the bidder is only required to notify the Takeover Commission without delay and in any event within 20 trading days, but there is no obligation to launch a mandatory bid. Target companies may lower the 30 per cent threshold through a provision in their articles of association and several companies have done so in response to takeover bids.

In addition, an acquisition of a direct or indirect interest conferring more than 26 per cent but not more than 30 per cent of the voting rights of a public company must be notified to the Takeover Commission without delay and in any event within 20 trading days; the voting rights exceeding 26 per cent are suspended (unless another shareholder has as many or more voting rights, the voting rights of the bidder are limited to 26 per cent by operation of the articles of the target company or the bidder already had such voting rights), but there is no obligation to launch a mandatory bid for the remaining shares.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

A private equity firm will generally seek to retain flexibility in its ability to sell its stake in a portfolio company, which may include having the right to request an initial public offering (IPO) or a trade sale after a minimum holding period (usually not exceeding five years) and the right to drag along other shareholders in the event of a sale by the private equity firm of all or a significant portion of its shares. Both exit rights and drag-along rights are usually subject to certain restrictions (eg, a pre-emption or a tag-along right or a minimum return requirement on the drag-along right), which may affect the private equity firm's ability to sell.

Private equity sellers are usually not prepared to accept substantial continuing liability to purchasers. As a consequence, they do not give business warranties and indemnities and instead just provide warranties on title and capacity. As mentioned in question 7, a purchaser must therefore often rely on its own due diligence and warranties from management, and accept limited recourse (eg, to a purchase price holdback, an escrow amount or the amount insured under warranty and indemnity insurance). The cost of warranty and indemnity insurance is usually part of the purchase price negotiations.

On an IPO, the portfolio company will have to satisfy the listing requirements of the relevant stock exchange. In addition, registration rights agreed in the shareholders' agreement may limit the percentage the private equity firm can sell into the IPO and lock-up restrictions agreed in the shareholders agreement or at the time of the IPO may limit the private equity firm's ability to sell any shares retained following the IPO (see also question 16).

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

An IPO does not invalidate rights or restrictions agreed between the shareholders. However, the underwriting banks will often push the private equity firm to give up any preferred rights prior to an IPO. Also, depending on how much the existing shareholders are diluted as a result of the IPO, they will often not have the required majority to enforce such rights and restrictions following the IPO.

In an IPO, the underwriter will usually expect part of the shares retained by the existing shareholders following the IPO to be locked up for a certain period to avoid downward pressure on the share price. Such lock-up obligations may already be included in the original shareholders' agreement, but this is rather the exception. It is more common to discuss lock-up obligations (in particular, in which proportion it applies to each shareholder that retains shares and the duration of the lock-up period) at the time of the IPO.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

There have only been a handful of completed going-private transactions in recent years, which makes it difficult to identify typical target industries. The difference in a private deal from a private equity firm's perspective is additional complexity and transaction costs because of the minimum pricing requirements under the Takeover Act (see question 14), in particular where there is a significant free float.

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Transactions involving a change of control of targets in regulated industries (see question 18) may be subject to advance notice or approval requirements, or both, which may affect timing.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Regulated industries

In regulated industries (eg, banking, insurance, utilities, gambling, telecoms or aviation) the acquisition of a qualified or a controlling interest is typically subject to advance notification or approval. Sanctions for failure to notify or obtain approval in advance differ and range from monetary penalties to ordering a suspension of voting rights, or a partial or total shutdown of the business.

Real estate

The acquisition of ownership and certain other interests in real estate by non-EEA nationals or the acquisition of control over companies owning such interests is subject to notification or approval by the local Real Estate Transfer Commission. What interests are covered and whether notification or approval is required varies across Austria from state to state. Where the real estate is used for commercial rather than residential purposes approvals are usually granted.

Foreign Trade Act

The acquisition of an interest of 25 per cent or more or a controlling interest in an Austrian business involved in defence and security services or public order and public services (for instance, hospitals, emergency and rescue services, energy and water supply, telecoms, traffic and universities) by a foreign investor (ie, an investor domiciled outside of the EEA or Switzerland) is subject to advance approval by the Minister of Economic Affairs under the Foreign Trade Act. Within one month of application, the Minister of Economic Affairs must either approve the transaction or initiate Phase II investigations. If Phase II investigations are initiated, the decision is due within two months of the application. If no decision is adopted within those time limits, the transaction is ex lege deemed approved. The application for approval must be filed prior to signing. Transactions subject to approval may not be completed prior to their approval. Failure to obtain approval is subject to imprisonment and criminal penalties. If the foreign investor relies on the exception for EEA and Swiss residents, the Minister of Economic Affairs may initiate ex officio investigations as to whether reliance on such exception is abusive.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Austrian law does not restrict multiple private equity firms, or a private equity firm and a strategic partner or other co-investor, from participating in a club or group deal. However, a club or group deal may raise additional antitrust concerns, which need to be analysed. In addition, where the transaction involves a public company, the partners in such deal will usually be considered to 'act in concert', and as such any shares held or acquired by them will be aggregated for determining the various thresholds under the Takeover Act and the Stock Exchange Act.

As a practical matter, each partner in a club or group deal may have different objectives (eg, a private equity firm usually has a different investment horizon from the strategic partner and may have a different investment horizon from another private equity firm) or target rates of return and structuring requirements that must be accounted for in the structuring of the transaction and the shareholders' agreement and ancillary documentation (eg, by introducing a special exit right or a liquidation preference for the private equity firm or a buyout option or special governance rights for the strategic partner where the strategic partner shall have control over the business and the private equity firm shall hold a purely financial interest).

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Austrian sellers have been generally successful in resisting closing conditions other than in relation to antitrust clearance or other regulatory approvals, material third-party consents and completion of agreed pre-closing restructurings. Sometimes material adverse change conditions have been accepted where required by a private equity purchaser to mirror a material adverse change condition in a debt commitment letter (but this is rather the exception) or where limited to adverse changes to the business (and not the economy or financial markets as a whole). Warranties being true and correct or pre-completion covenants having been satisfied were the exception.

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Brazil

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

A wide variety of types of private equity transactions occurs in Brazil, from majority or control acquisitions to minority acquisitions and management buyouts. A relevant difference, compared with other markets, is that leverage is not commonly used, for various reasons, including financing costs, availability of credit lines and size of transactions, among others.

The most common structure has a private equity fund (FIP) as the main investment vehicle. The reason for the popularity of this type of fund is that it offers specific tax advantages, especially for foreign investors, if certain conditions are met.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

It is substantially costlier to remain a public company. Going private avoids certain statutory governance requirements, all compliance costs related to filing reports with the Brazilian Securities Commission (the CVM) and the Stock Exchange (in this last case, if the shares are listed on a stock exchange), not to mention the related legal liability.

Additionally, if the company is listed on a special segment of the stock exchange, such as the Novo Mercado (see question 16) (as is the case for a substantial number of companies), relevant governance requirements will have to be complied with, such as hiring independent board members, creating special audit committees, establishing a fixed term of office for board members, creating special requirements for tender offers and public offering of shares, among others.

Brazil adopts a two-tier management structure for corporations, the most commonly used vehicle for companies involved in large transactions. These entities may have a non-executive board of directors, elected by the general shareholders' meetings, and a board of officers, elected by the board of directors. For public companies, the existence of a non-executive board of directors is mandatory, while for private companies it is optional. Brazilian corporation law establishes certain matters as exclusive for shareholders' meetings, boards of directors and boards of officers. For example, only shareholders may decide on mergers, spin-offs, dissolutions and changes of business purpose, among other matters. Likewise, only the non-executive board of directors may decide on the election of executive officers and choice of independent auditors.

The acquisition of a controlling interest in a public company usually triggers a mandatory tender offer to acquire the shares of the remaining shareholders, of which the terms and conditions shall be equal to those offered to the selling controlling shareholders.

Also, before taking the company private, the company itself or the controlling shareholders must make a tender offer to acquire all outstanding shares. The tender offer price must be set based on the company's fair market value, to be confirmed through a special independent report. At least two-thirds of the outstanding shares must approve the decision to go private or adhere to the offer.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

In Brazil, going-private and private equity transactions are matters discussed by the shareholders rather than by the board of directors, since most of the companies have majority controlling shareholders.

Conflicts of interest and particular benefit transactions between the company and its shareholders are issues commonly present in transactions involving public companies. Conflicts of interest between the company and its directors also occur, although not as often.

Brazilian law establishes that a director shall not intervene in any transaction in which he or she has a conflicting interest (ie, he or she can neither vote nor participate in the discussions related thereto).

The CVM recommends that, in merger transactions involving companies with the same controlling shareholder, the management shall:

- effectively negotiate the merger agreement to be submitted to the shareholders' meeting;
- provide the appropriate disclosure to the market;
- seek the best terms for its respective companies;
- obtain all relevant information to take its decision, and have the appropriate time to perform its duties;
- decide whether to hire independent financial and legal advisers;
- oversee the work of the independent advisers;
- propose alternative transaction structures;
- reject the transaction, if the proposed transaction does not seem fair;
- provide the basis for and document all decisions taken; and
- make the relevant documents therein available to all shareholders.

The CVM also recommends that:

- an independent committee be formed to review the transaction and submit it to the board of directors; or
- the transaction not be submitted to the controlling shareholders.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Generally, in Brazil, any act or fact that may have an impact on the shareholders' decisions to buy or sell securities of a public company, shall have a heightened disclosure standard. Undoubtedly a going-private initiative shall be the subject of a broad disclosure procedure.

It is necessary to stress that, if a public company or its controlling shareholder decides to take the company private, the company itself

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or its controlling shareholder shall make an offer to acquire all of the outstanding shares of the company at a fair price. Shareholders representing at least two-thirds of the outstanding shares – excluding shares owned by the controlling shareholders, management or related parties – shall either approve or adhere to the offer. This tender offer is subject to specific and heightened disclosure requirements, such as material fact announcements and detailed tender offer notices.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Generally the following time constraint issues shall be taken into account when planning a private equity transaction:

- tender offer procedures in a going-private transaction (approximately 210 days);
- tender offer procedures in a sale of control transaction (approximately 120 days);
- approval of applicable government authority, especially in public concessions, financial institutions or regulated sectors (time varies based on the industry and percentage of investment, but never less than 30 days);
- approval by antitrust authorities (approximately 60 days in the fast-track scenario),
- the time necessary to negotiate the transaction and complete the due diligence (time varies depending on complexity, size and other factors, but never less than 90 days).

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

As mentioned previously, if a public company or its controlling shareholder decides to take the company private, the company itself or its controlling shareholder shall make an offer to acquire all the outstanding shares of the company for a fair price.

Shareholders representing at least 10 per cent of the outstanding shares (ie, under Brazilian law, outstanding shares are all those in circulation on the open market, except for shares held by the controlling shareholder, officers, directors and shares held in treasury) may request the convening of a shareholders' meeting (ie, to be attended only by the holders of outstanding shares) to approve the commissioning of an independent appraisal to challenge the tender offer price. If the shareholders decide to hire the appraisal and the appraisal report presents a fair price higher than that of the tender offer, the offering party may withdraw the offer or increase the tender price to that of the appraisal report.

In any case, shareholders representing at least two-thirds of the outstanding shares (for the purpose of the calculation of this quorum, only the shareholders that have either expressly agreed with taking the company private or those who have registered to participate in the offer shall be taken into consideration) shall either approve or adhere to the offer. If such threshold is not met, the tender shall be terminated and the company may not go private.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

A Brazilian M&A transaction generally follows the US standard. The purchase agreement usually has the following provisions:

- representations and warranties:
  - regarding business and operation of the company (eg, labour matters, tax matters, licences, real estate matters, intellectual property, information technology, environmental, financial matters, assets, debts, material agreements); and
  - regarding the formation of the company (eg, corporate authority, ownership of shares, share capital);
- buyer's indemnification rights regarding liabilities and contingencies resulting from an act or fact that occurred before the transaction:
  - types of indemnification clauses:
    - full liability;
    - exclusion of all liability;
    - liability applied only after a minimum value of indemnification is achieved (basket);
    - liability limited to a maximum value;
    - liability limited to a specific term; and
    - liability limited to contingencies found in due diligence;
- warranties stemming from indemnification rights (applied by the buyer):
  - retention of instalments that have not reached maturity yet;
  - escrow of a portion of the purchase price;
  - mortgage;
  - pledge; and
  - personal guarantees; and
- non-compete clause that has to be restricted to a certain period and territory.

In addition, there are certain mandatory governance restrictions on companies invested by private equity funds that are usually included in the transactions documents, such as:

- prohibition of the issuance of founders' shares;
- unified mandate up to two years for board members;
- choice of arbitration for dispute resolution;
- in the case of going public, adherence to special listing segment of the stock exchange;
- audit of financial statements of the company by independent auditors registered with the CVM; and
- right to appoint board members.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In a going-private transaction, the management of the target company may be offered the option (or may be required) of acquiring shares of the target company or of the acquisition vehicle used for such transaction.

Generally, management also receives equity incentive awards (eg, stock options). Such equity awards are based on the following concepts:

- continued employment;
- return of investment of the private equity sponsor; and
- achievement of goals by the company.

This agreement usually provides that in the case of termination of employment the acceleration of vesting may occur, repurchase or forfeiture of the equity incentive awards (the acceleration, repurchase or forfeiture depends upon the circumstances for the termination of employment). Also, it often provides that, following such termination, the management may not compete with the company or hire the company's employees.

In addition, management participating in a private equity transaction may present several opportunities to earn significant value. Thus shareholders of a public company are particularly concerned about conflicts between management's request to complete a transaction and interests of private equity buyers, on the one hand, and shareholders' desire to maximise value in the going-private transaction, on the other.

In an attempt to avoid a potential conflict, the board of directors may restrict the participation of the senior management in certain aspects of going-private negotiations or discussion of the compensations arrangements until the price and relevant terms and conditions of the sale are fully negotiated with the private equity firm, and, in some cases, completed.

In Brazil, as in the United States, the CVM usually requires that final management conflicts are disclosed, including the amount earned by the management in a transaction.

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9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The type of vehicle that will be used to channel the investment by private equity investors is a key issue in determining the overall tax treatment of the structure. One crucial issue is whether the relevant vehicle is considered a legal entity for Brazilian tax purposes (in the case of a limited company or a corporation; in the case of a Brazilian investment fund, which, except in certain circumstances, is not considered a legal entity for Brazilian tax purposes).

The basic tax issues involved in private equity transactions are:

- deductibility of goodwill – the portion of the purchase price that may be allocated to future profitability of the target company may be deducted as an expense if certain conditions are met. The tax savings using this legal provision can be substantial. Thus the acquisition structure and price to be paid by the acquirer should consider it;
- deductibility of interest – third-party and sellers' financing expenses may be deducted by an operating company, usually the target company. The transaction shall be structured to take advantage of such deductibility; and
- a transaction's tax structure.

The tax issues related to management compensation are:

- taxation of stock option plan – the plan shall be carefully structured in order to avoid being treated as regular compensation subject to regular higher levies; and
- taxation of bonus – Brazilian law provides for certain tax exemptions related to bonuses and participation in the results of the company. Such compensation schemes shall be carefully structured in order to avoid additional taxes.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

In private equity transactions the most common sort of leverage is seller's finance and, to a lesser extent, bank finance.

Loan agreements in Brazil usually have change of control provisions, requiring a prior approval by the bank for a sale of the company.

Specific restrictions on debt financing and security interests such as the aforementioned are not usual here.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Purchase agreements in going-private transactions usually set forth representations and warranty provisions relating to the debt and equity financing commitment of the private equity firm. They also set forth representations and warranty provisions regarding third-party debt-financing commitments obtained by the private equity firm at the time of entering into the purchase agreement.

A purchase agreement may (or, as is more frequently the case, may not) condition the closing of a transaction on the receipt of financing proceeds by the private equity firm. If the closing is not conditional on the receipt of financing proceeds, the purchase agreement may provide a deadline for the private equity firm to obtain the financial resources necessary to complete the transaction. If the private equity firm has not obtained the proceeds of such financing by the end of the period provided and thus fails to close the transaction, the private equity firm may be required to pay a reverse termination fee.

Generally, the private equity firm obtains the financial resources for completing the transaction through bank finance, by signing the corresponding financial documents.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

In highly leveraged transactions, the assets or equity of the target company are issued or transferred to a private equity fund in exchange for the proceeds of acquisition financing, which are generally secured by the assets or equity of such target company.

Such transactions shall be carefully verified by the private equity buyer, seller and management of the target company so that they are not invalidated based on the concept of fraudulent conveyance.

In Brazil, a leveraged transaction would be invalidated through fraudulent conveyance if, cumulatively:

- an insolvent company transfers its assets or such asset transfer makes it insolvent;
- such transaction is performed with actual intent to hinder, delay or defraud any creditor; and
- if, in the event of issuance or transfer of assets or equity, the company is evidently insolvent or there are enough reasons for such insolvency to be known to the buyer.

Also, the debt guarantees that the insolvent debtor has given to creditors are presumed to be fraudulent.

As an alternative to protect the private equity buyer, the purchase agreement may contain representations and warranties by the target company's chief financial officer regarding the solvency of the target company.

In addition, fraudulent conveyance issues should be carefully considered by sellers or management, who should review the financial effects of such transaction for the target company, as the debt will remain in place following the closing of the transaction.

In Brazilian bankruptcy law, the judicial decision granting bankruptcy shall set forth a legal term of bankruptcy (the Legal Term). There are some acts carried out during the Legal Term that may be deemed unenforceable, including the following:

- repayments of indebtedness not matured or, if the indebtedness is due, in a manner different from the one contractually agreed;
- constitution of a lien or other security interest to existing indebtedness; and
- transactions without consideration entered into during the two-year period before the bankruptcy.

Also, in Brazilian bankruptcy law, a sale or transfer of the business may also be deemed unenforceable if it was made without the express consent of the creditors or payment of all creditors, and it had the effect of leaving the company with fewer assets than would be necessary to pay all its debts.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

The key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms are:

- right to appoint a certain number of directors and officers;
- right to approve certain transactions (eg, change in control transactions, affiliate transactions, certain equity or debt issuances and dividends or distributions);
- right to allow the minority investors to maintain the same percentage equity ownership after a primary equity issuance by the target;
- transfer restrictions, tag-along rights (the right of a shareholder to transfer securities to a person who is purchasing securities from another holder);

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- right to receive information regarding the target company, access to financial reports, books and records, and management of the target company; and
- not to compete with the subject company or a veto to make investments outside the subject company that may be a potential investment or acquisition opportunity for the subject company; and
- right of first offer or right of first refusal.

Also, there are legal provisions to protect the minority shareholders, as follows:
- right of withdrawal in circumstances provided in Brazilian corporate law (eg, merger, incorporation, spin-off, participation in group of companies);
- tag-along rights with transfer of control of a public company;
- shareholders representing at least 15 per cent of the outstanding shares issued by a public company (with voting rights) have the right to appoint and remove a member of the board of directors and statutory audit board and his or her alternate member in a special shareholders' meeting – excluding the controlling shareholder;
- shareholders representing at least 10 per cent of the outstanding shares may request the convening of a shareholders' meeting to approve the commissioning of an independent appraisal to challenge the tender offer price;
- shareholders representing at least two-thirds of the outstanding shares – excluding shares owned by the controlling shareholders, management or related parties – shall approve or adhere to the tender offer for the company to go private; and
- shareholders representing at least 0.5 per cent of the outstanding shares may require the addresses of shareholders for the purpose of granting powers of attorney for their representation in shareholder's meetings.

In addition, there are essential rights applied to all shareholders (including minority shareholders) set forth in Brazilian corporate law:
- to participate in the corporate profits;
- to participate in the assets of the corporation in the case of liquidation;
- to supervise, in accordance with Brazilian corporate law provisions, the management of the company's business;
- right of first refusal in the subscription of shares, founders' shares convertible into shares, debentures convertible into shares and subscription bonuses; and
- right of withdrawal in the circumstances defined in Brazilian corporate law.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

In the case of control acquisitions, the acquirer shall carry out a mandatory tag-along tender offer. The acquirer shall tender for the remaining voting shares of minority shareholders issued by the company, for a price that corresponds to at least 80 per cent of the value, per share, paid to the controlling shareholder or controlling group. In the Novo Mercado segment, the tag-along price shall be 100 per cent.

Acquisitions of control in certain sectors are restricted for foreign investors. In others, changes of control shall be subject to previous approval by government agencies.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Some of the key limitations may be indemnification discussions related to tax, labour, environmental and – more recently – corruption issues. These sorts of liabilities may take time to appear after the sale transaction is closed and may be relevant. Therefore, time and amount limitation of indemnification provisions are usually difficult discussions.

Update and trends

Over the past few years, a substantial number of M&A transactions in Brazil were driven by the impact of the 'Car Wash Operation' (*Operação Lava Jato*), which was the largest-scale police operation against corruption in the country. Some of the largest Brazilian enterprises were involved and suffered financial constraints related to penalties applied, indemnification obligations, breach of contracts with government entities and loss of reputation. There have been capitalisations, sales of controlling interests, sales of assets and IPOs, among others.

One of the most relevant legal issues that arises from these transactions is the potential liability related to local anti-corruption laws and to what extent such liability may affect not only the target company or asset, but also the purchase and sale transaction itself.

Furthermore, there is no limit of liability for investors in FIPs. Therefore, any FIP indemnification obligations in a share purchase agreement may be enforced against the quotaholders.

Generally speaking, all mechanisms of post-closing recourse, such as indemnification, escrow and insurance may be used in Brazil. However, the use of insurance is the least commonly used owing to the limited availability of such policies in Brazil.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Most Brazilian IPOs are made on a specific segment of the Securities, Commodities and Futures Exchange (Bovespa) called Novo Mercado (new market), although some offerings have been on other segments. Novo Mercado has a strict governance-driven set of rules that includes:
- prohibition to issue non-voting shares;
- tag-along rights to the minority shareholders for 100 per cent of the price per share paid to the controlling shareholders;
- tender offer to acquire minority shareholders in the event the company decides to leave the Novo Mercado segment;
- minimum number of independent board members;
- regular performance assessment for directors, committees and officers; and
- maintenance of minimum free-float threshold.

Usually lock-up restrictions for relevant shareholders or management extend to a six-month period from the offering. After such period for an additional six-month period, the shareholders shall not sell more than 40 per cent of their shares. Sponsors usually dispose of their stock through block trades and follow-on offerings.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

There have been a few going-private tender offers in recent years, which were mainly driven – we believe – by the low market capitalisation of public companies until the end of 2016, rather than by specific kinds of companies or sectors.

Certain industry-specific regulatory schemes limit the potential targets of private equity firms. Sectors such as banking, energy, insurance, media, telecommunication, utilities and acquisition of rural land must comply with special business combination laws and regulations, including restrictions on foreign investment.

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18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There is a substantial number of issues related to structuring and financing cross-border transactions in Brazil. We briefly mention the following important ones:

- restriction of foreign investment in certain sectors such as aviation, education and ownership of rural land;
- previous authorisation for change of control in certain regulated sectors, especially public concessions;
- in the case of direct or indirect change of control in public companies, there is a legal requirement to make a tender offer to acquire minority shareholders;
- in the case of going-private transactions, there is a legal requirement to make a tender offer to acquire minority shareholders;
- appraisal rights of minority shareholders in certain types of merger and spin-offs;
- need to notify, and obtain approval from, the antitrust authorities in certain relevant transactions; and
- tax considerations related to disposal of assets, shares, taxation of profits generated by foreign subsidiaries of Brazilian companies, among others.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

We are not aware of any country-specific considerations relating to group deals in Brazil. As general rule, participants should look at their specific co-investment provisions in their by-laws. Brazilian local private equity funds usually contain provisions related to co-investment.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Key issues would include:

- approval of antitrust authorities;
- success of tender offer to minority shareholders of a public company, whenever applicable; and
- approval by public authorities.

These issues may be resolved by any of the following: termination rights, fees or closing conditions. However, the most common way of resolving issues that may substantially affect the deal or the business of the acquisition target is the use of closing conditions.

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Cayman Islands

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Leveraged acquisitions, management buyouts, development capital investments, fund organisations, divestitures and recapitalisations are all types of private equity transactions that occur in the Cayman Islands.

The most commonly used vehicle for private equity funds in the Cayman Islands is the exempted limited partnership established under the Cayman Islands Exempted Limited Partnership Law, 2014, which affords limited liability status to investors who are limited partners in the limited partnership provided that they do not take part in the conduct of the business of the limited partnership. The fund's sponsor, or an affiliate, typically acts as the general partner and has unlimited liability for the limited partnership's obligations. Some private equity fund managers may choose to establish a fund as a Cayman Islands exempted company or a limited liability company (LLC) where there are good reasons to do so, including as to taxation or to mirror an onshore structure using Delaware LLCs, for example. A Cayman Islands private equity fund would traditionally use exempted companies as portfolio companies for investments and acquisitions, however, since the introduction of LLCs in the Cayman Islands, LLCs have become an alternative option for portfolio companies.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The reporting requirements of overseas fund managers managing private equity funds (for example, reporting requirements of US fund managers who are SEC-registered) has implications for Cayman Islands private equity funds, as those fund managers are aligning their management of the funds and corporate governance generally with best practices expected by the regulators.

The effect of corporate governance rules on companies that, following a private equity transaction, remain or become public, will be subject to the corporate governance obligations imposed by the regulator of the relevant exchange.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

In making their decisions at board level, the directors have fiduciary duties to do the following, among other things:

- act in good faith in the best interests of the company;
- act for a proper purpose in accordance with the constitution of the company; and
- avoid circumstances that create a conflict of interests between the interests of the director and the interests of the company.

As a general principle, these duties are owed to the company and not to individual shareholders.

A conflict of interest will arise if the directors' interests do not align with those of the company. In the context of a 'take-private' transaction, directors are under a duty to act in good faith when advising shareholders on the merits of a transaction but are under no obligation to give such advice.

In cases where the controlling shareholder has control of the board or senior management, or members of the board are participating in the transaction, it is the norm for Cayman Islands companies to establish special committees consisting entirely of independent and disinterested directors to negotiate the transaction to ensure arm's-length third-party negotiations and to avoid conflicts of interests.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

There are no specific disclosure obligations on the directors of the target company under Cayman Islands law in a 'take-private' transaction, other than the directors' fiduciary duties and their common law duty to act with due care and skill in exercising their functions for and on behalf of the company.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The timing considerations for a 'take-private' transaction are subject to the takeover mechanism used to effect the acquisition of the target company in the Cayman Islands. The mechanism most often used is to have a merger (under the merger regime in Part XVI of the Companies Law (2016 Revision) (the Companies Law)) between the target and an acquiring newco (which has been financed for the transaction). Other legal mechanisms used are schemes of arrangement under sections 86 to 87 of the Companies Law and takeover offers utilising the 'squeeze-out' provisions contained in section 88 of the Companies Law.

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In the case of a merger, the timing from commencing the 'take-private' to applying to register the merger (in order for a Certificate of Merger to be issued by the Cayman Islands Registrar of Companies) will depend on the complexity of the transaction and the timing for obtaining tax and regulatory clearances but can be between two and three months, which is usually shorter than the time periods for a scheme of arrangement or tender offer.

In the case of a scheme of arrangement, a precise timetable will need to be agreed with the Grand Court of the Cayman Islands. In practice, this process is likely to take up to three months from the date of settling the scheme document and commencing the court-based scheme proceedings, to sanction of the 'take-private' pursuant to the scheme by the Grand Court. However, the overall time period for a scheme of arrangement from beginning to end often takes significantly longer than three months. The merger regime has a number of advantages over the scheme in terms of timing. For example, the lack of court supervision under the merger regime provides the target company with more manoeuvrability in the event of a competing, unsolicited (or hostile) bid being made because there would be no need for the target company to deal with obtaining court approval for its actions or otherwise to keep the court informed of what it is undertaking and how that might bear on the scheme of arrangement at hand. The approval threshold for a merger is lower than the approval threshold for a scheme of arrangement.

While there is no maximum time period in completing a takeover, if the 'squeeze-out' provisions are being utilised and the bidder meets the 90 per cent minimum acceptance condition within four months of the date of the offer being made, the bidder will (unless the minority or dissenting shareholders make an application to the court) be able to compulsorily acquire the outstanding shares held by the minority or dissenting shareholders one month from the bidder's notice to acquire such shares.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

In respect of the mechanism most often used for a 'take-private' transaction, the merger and consolidation under Part XVI of the Companies Law, in order to implement such a merger, a plan of merger, approved by the directors, must be put to the shareholders of each constituent company for approval. The threshold for such approval is a special resolution of the shareholders, all voting as one class, unless a higher threshold is required under the company's memorandum and articles of association. A special resolution is at least two-thirds majority (or such higher number as may be specified in the constituent company's articles of association). However, under the Companies Law, a member of a constituent company shall be entitled to payment of the fair value of his or her shares upon dissenting from a merger. Such fair value shall be agreed between the company and each dissenting shareholder or, in the absence of such agreement, by the court. The court will then determine the fair value together with a fair rate of interest (if any) to be paid by the target entity upon the amount determined to be the fair value. The costs of these proceedings may be determined by the court and taxed upon the parties as the court deems equitable in the circumstances. *In the matter of the Integra Group* (which is the only Cayman Islands case law on the meaning of 'fair value' in this context) on 28 August 2015, the Grand Court ruled that assessing fair value is a 'fact-based exercise in each case' but that fair value was a member's pro rata share of the value of the company's business as a going concern at the date of the extraordinary general meeting to approve the merger. Crucially, this amount should be without reference to any minority discount or any premium for the forcible taking of the shares. There is no prescribed approach in the Companies Law as to valuation. Accordingly, any techniques or methods that are generally considered acceptable in the financial community should be used. In the *Integra* case, experts were appointed by each party with the court ultimately approving the methodology of the dissenter's experts. Furthermore, the court also ruled that the fact a company's shares are listed on a major stock exchange will not lead the court to determine that a valuation methodology based upon its publicly traded price is necessarily the most reliable approach. Again, it will depend on the facts of each specific case as to whether the court would use this or not. In any event, this procedure ensures that a dissenting shareholder cannot delay the 'take-private' transaction and also enables the directors to take some comfort when considering their fiduciary obligations to ensure the interests of all shareholders are protected.

If a scheme of arrangement is used, under sections 86 to 87 of the Companies Law, a higher threshold of approval is required, being a majority in number of affected (ie, independent) shareholders on a show of hands, whose collective shareholding must be at least 75 per cent of the shares being voted at the meeting. As schemes of arrangement require the consent of a majority in number (as opposed to a vote based on shareholdings in a merger) this can lead to some difficulty in listed companies who might have small numbers of registered shareholders (for example, where shares are predominantly held by nominee shareholders) as this would mean a registered shareholder with a comparatively low shareholding may potentially block the scheme of arrangement. The same issue would not arise with the merger route described above. However, if a scheme of arrangement is approved, any dissenting shareholders are bound by the decision of the majority.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Private equity buyers will, in addition to the standard terms contained in these types of purchase agreements, seek comprehensive representations and warranties, indemnities, seller or management earn-out provisions, seller rollover requirements or restrictive covenants. On the investment aspects of the transaction, the private equity buyer will seek to have provisions dealing with a number of investor consent matters including borrowing, capital expenditure, financing, control on management remuneration, exit strategy provisions and employee incentivisation plans or schemes.

In contrast, on exit, private equity sellers typically only provide limited warranty protection, with short claim periods and no guarantees or post-completion covenants.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In performing his or her fiduciary duties as a director, a director is under an obligation not to put him or herself in a position where there is an actual or potential conflict between his or her duty to the company and his or her personal interests. Notwithstanding this obligation, a director may participate and become part of a compensation-based structure in a private equity transaction provided that the following occurs:

- any conflict of interest is disclosed and such disclosure and participation by the director is permitted or can be waived under the company's articles of association;
- there has been no breach of fiduciary duties by the participating director; and
- there are no circumstances giving rise to the participating director having used the company's assets, opportunities or information for his or her own personal profit.

There are no statutory or regulatory restrictions or disclosure requirements in relation to principal executive compensation under Cayman Islands law.

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9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Under current Cayman Islands law, there are no Cayman Islands taxes on income or gains of the private equity entity or the portfolio company or on gains on dispositions of shares or partnership interests, and distributions made by the private equity buyer or portfolio company will not be subject to withholding tax in the Cayman Islands.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

There are currently no regulatory restrictions in the Cayman Islands on the use of debt financing for private equity transactions. Secured senior debt, high yield or mezzanine debt, secondary debt, loan notes and payment-in-kind notes are all types of finance mechanisms used in the Cayman Islands to finance 'take-private' or other private equity transactions. There are no financial assistance restrictions in the Cayman Islands.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

The provisions relating to debt and equity financing will typically be the commonplace terms that are normally negotiated and settled between the parties to the private equity transaction. There are no special Cayman Islands law considerations that are required to be factored into these provisions.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

To the extent that a private equity transaction involving leverage impacts on the solvency of the target and its subsidiaries (all or some of which are typically required to provide security for the financing obligations of the acquirer), there will be 'bankruptcy' related issues, such as the following:

- statutory provision for voidable preferences – which makes invalid every conveyance or transfer of property, or charge thereon, or payment obligation, etc, made, incurred, taken or suffered by the company in favour of a creditor with a view to giving such creditor a preference over other creditors at any time when the company is unable to pay its debts if the conveyance or transfer of property, or charge thereon, or payment obligation, etc, was made, incurred, taken or suffered by the company within six months preceding the commencement of its liquidation;
- statutory provision for avoidance of dispositions at an undervalue – every disposition of property made at an undervalue by or on behalf of the company with an intent to defraud its creditors is voidable at the instance of the company's liquidator; and
- fraudulent dispositions – under the Fraudulent Dispositions Law (1996) every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of a creditor thereby prejudiced if the action is brought within six years of the disposition happening.

These issues are typically handled by structuring the transaction in such a way so as to avoid fraudulent conveyance or other 'bankruptcy' issues from arising.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

The key provisions that drive the structure of shareholder agreements in private equity transactions are focused on retaining control over key operational decisions during the term of the investment, regulation of share transfers (including compulsory transfers in certain circumstances), liquidity and exit procedures. Protections afforded to minority investors include: veto rights over certain operational decisions (ie, restricted matters that require the consent of all the shareholders), pre-emption rights on transfer, tag-along rights, board appointment rights and rights to receive information. As a breach of these protections under the shareholders' agreement would only entitle the aggrieved shareholder to claim damages for breach of contract and not reverse the breach, it is important that these protections are also included in the company's articles of association (which would also then bind any shareholder who is not party to a shareholders' agreement).

Under the Companies Law, special resolutions (which require the approval of at least two-thirds of the shareholders unless the articles of association of the company stipulate a higher threshold) are required for specified actions including: the reduction of the share capital of the company, any amendments to the memorandum and articles of association of the company, any application to wind-up the company; and with respect to the approval of a merger involving the company.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

There is no mandatory takeover offer or minimum capitalisation requirements under Cayman Islands law. However, in order to acquire a controlling stake by way of a takeover utilising the statutory 'squeeze-out' provisions or by way of a scheme of arrangement, the acquirer will need to meet the statutory thresholds set in order to trigger the compulsory acquisition of the remaining shares (which is currently 90 per cent to activate the statutory squeeze-out mechanism and 75 per cent under a scheme of arrangement).

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Provided that appropriate institutional drag-along rights have been included in the shareholders' agreement or articles of association of the company, a private equity firm should be able to sell its shareholding in a portfolio company to a third party without restriction.

Another limitation on the ability of a private equity firm to sell a portfolio company or conduct an IPO of a portfolio company will also be where the fund is in its agreed life cycle. Where a fund reaches the end of its agreed life but still has a portfolio company, an extension of the fund may result in penalties for the fund manager. Accordingly, there may be an incentive to sell the asset for whatever value can be achieved prior to the end of the fund's agreed life rather than attempting to maximise the return in the longer run. A fund seeking a quick exit will usually approach another PE fund as they tend to be the most liquid acquirers. In particular, funds that are underinvested and are approaching the end of the investment period have strong incentives to invest or lose access to the committed capital. Accordingly, a fund's life cycle is a very important factor in relation to any exit, whether by sale or IPO.

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Private equity firms will normally seek a 'clean exit' on the sale of a portfolio company rather than at the expiry of claim periods or on the satisfaction of escrow conditions and this would typically be factored into the buyer's offer.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Once listed, the operations of the portfolio company will be governed by the listing rules and regulations of the exchange and jurisdiction in which the portfolio company is listed. Governance rights and other rights and restrictions typically included in a shareholders' agreement such as board appointment rights, veto rights over restricted matters and special information rights are generally not permitted post-IPO.

There are no restrictions on registration rights for post-IPO sales of shares in the Cayman Islands. Lock-up restrictions for private equity firms vary depending on the circumstances and contractual obligations of the parties, but IPO underwriters typically require in the underwriting agreement or lock-up agreement that private equity firms should not sell any shares in the portfolio company for up to 180 days following the IPO.

Whether a PE sponsor can divest itself of stock following an IPO will largely be driven by both market conditions and listing rules and regulations of the exchange and jurisdiction in which the portfolio was listed. Typically, a sponsor will look to sell down a portion of its shares on the IPO, but where a sponsor has been blocked from selling any or all or its stock the sponsor will need to rely on strong public markets to complete an exit through follow-on public offerings in relation to which it will seek to include its stock in such offering.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

As the Cayman Islands is a popular jurisdiction for a holding company structure, there is a very wide range of companies and industries that have been the target of 'take-private' transactions in recent years. There are no industry-specific regulatory schemes or anti-trust laws in the Cayman Islands that limit the potential targets of private equity firms.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There are no foreign investment restrictions, minimum capitalisation requirements or financial assistance restrictions in the Cayman Islands which would lead to specific structuring issues in a cross-border 'take-private' or private equity transaction. The tax-neutral status of the Cayman Islands (see question 9) also means that there are no adverse tax consequences from a Cayman Islands perspective.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

There are no specific Cayman Islands legal considerations that would apply to a private equity transaction involving syndicated parties other than the typical general considerations that would include: the valuation of the investment price, pre-emption rights, investor consent requirements, the make-up of investor majority, timing, terms of disposal pre-exit, restrictive covenants and exit provisions.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

The key issue relating to certainty of closing arises from the delay between exchange of contracts and closing (with closing happening upon the satisfaction or waiver of a number of conditions precedent in the transaction documents). The principal concern for the seller will be to ensure that the conditions precedent (applicable to the seller) are clear, specific and achievable within the time frame set for closing. The principal concern for the private equity buyer will be to ensure the synchronisation of the conditions precedent (applicable to the buyer) in the finance, equity investment and acquisition documents. For example, the private equity buyer will want to ensure that it is not legally obliged to buy the target until the conditions precedent relating to debt finance and equity finance have been satisfied or waived. These issues are typically resolved through negotiation. There are no Cayman Islands-specific considerations that are required to be factored into such negotiations.

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China

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

There may not actually be a simple method for defining private equity transactions. In Chinese practice, two basic transactional scenarios are usually considered, as follows:

- equity transactions in a private or non-listed company, which can either take the form of a limited liability company or a company limited by shares, as defined in Company Law of the People's Republic of China (PRC) (revised 2013 and effective 1 March 2014) (the Company Law); and
- transactions involving a public or listed company as target, for instance, a private offering of shares by a listed company.

The first type of private equity transactions can be classified in a variety of ways. In terms of the origin of the funds, US dollars funds set up overseas (such as in the Cayman Islands, British Virgin Islands or Hong Kong) were once the major players participating in private equity investment in non-listed companies. However, domestic yuan funds have become increasingly active and prominent in the market in recent years. As for the types of investors involved, some transactions are conducted by professional financial investors, while others are helmed and driven by strategic investors, such as the well-known Baidu, Alibaba and Tencent for business cooperation or industrial development purposes. According to the stage of the target company, these transactions can be divided into seed or set-up investments, angel investments, venture capital and growth capital transactions, etc. Based on the industry of the target company, the majority of private equity transactions in the past few years have occurred in internet and mobile internet sectors, including internet financing services, medical and healthcare, e-commerce and cultural and entertainment businesses.

With respect to private equity transactions involving listed companies, unlike other mature capital markets (eg, the United States, the United Kingdom and Hong Kong), leveraged buyouts and going-private transactions are not very common in China. Owing to China's examination and approval scheme for listing, a listed company itself is a valuable resource, regardless of its assets and business. Shareholders, investors and management usually devote years of effort to become listed and pursue public liquidity for their equity in the company, not to mention the reputational and financial advantages of the company being listed for future development. At the same time, players in China's private equity arena are occasionally exposed to the privatisation transactions of US-listed Chinese companies (eg, Qihoo 360 (formerly NYSE: QIHU) and Youku.com Inc (formerly NYSE: YOKU)), which seek relisting on the Shanghai or Shenzhen exchanges.

The dominant type of private equity transaction involving China's listed companies may be the private offering of shares, which is similar to private investment in a public equity in the US. Chinese listed companies often conduct this type of transaction for financing purposes, and the investors mainly include trust companies, commercial banks and private equity funds, but sometimes these transactions are driven by strategic investors. For example, China's home appliance giant, Haier, completed its 2013 private offering to private equity investor KKR in order to expand Haier's business overseas. In addition, private equity funds established in accordance with PRC law, including acquisition, equity investment, venture capital and industry investment funds, have been encouraged to participate in mergers, acquisitions and reorganisations of Chinese listed companies.

In terms of the structure used in private equity transactions, share equity investment and mezzanine investment are the typical methods. Simple agreements for future equity are hardly seen in China's angel investment and venture capital transactions, although these are very common in Silicon Valley. Meanwhile, given the regulatory environment for foreign investment in China, a lot of transactions employ VIE or captive structures to bypass regulations prohibiting or limiting foreign investment in certain types of business, such as telecommunications and the internet, education and media. In the recent past, the future of this practice was brought into question by a draft Foreign Investment Law. However, a final draft was never issued and the status of the previous draft remains unknown. Additionally, equity crowd-funding has become very popular around the globe, and this is also the case in China. Many players in the crowd-funding sector have attempted to transform and improve their private equity game, and the Chinese government is also working on regulating the healthy development of crowd-funding investment.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

China's corporate governance rules are generally incorporated in the Company Law and further supplied by specific regulations regarding listed companies and foreign-invested companies. Unlike countries with an Anglo-American legal system, where the board of directors usually welds most power in corporate governance, the ultimate managing power in China is allocated differently according to the type of company. In domestic limited liability companies, companies limited by shares (either listed or unlisted) and wholly foreign-owned enterprises, the general meeting of shareholders is entitled to make decisions on all matters of importance, leaving the board with daily management and execution of the shareholders' decision. However, in Chinese–foreign equity joint-ventures and contractual joint-ventures, there is no shareholders' meeting or equivalent, and the board of directors (or the joint management body in contractual joint ventures) is empowered with all rights. As such investors in private equity transactions have to take this reality into consideration and manage their preferred rights, such as veto rights and appointment of directors, accordingly.

As for other capital markets, the China Securities Regulatory Commission of the PRC (CSRC) and the exchanges (there are two exchanges in China: the Shanghai Stock Exchange and the Shenzhen Stock Exchange) set higher corporate governance and information disclosure standards on listed companies than ordinary private companies. Naturally, after a going-private transaction, the company faces fewer statutory requirements and enjoys more efficiency and flexibility during its daily operation. Such advantages, however, are often outweighed by the advantages that come with being a listed company in

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China at the present (see question 1). This may change if a new registration scheme for listing is promulgated by the CSRC in the future.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

As mentioned in question 1, going-private transactions seldom occur in China. However, the law has provided rules and directives that should be followed by the board of directors of public companies when they face a takeover offer or when conducting private offerings of shares.

Takeover of a listed company

According to Administrative Measures on Takeover of Listed Companies (amended in 2014) (the Takeover Measures), when considering whether to enter into a takeover transaction, the board of directors of the listed company must investigate the entity's qualification, creditworthiness, intent for the acquisition and, further, analyse the terms of the offer, make a recommendation to the shareholders regarding whether to accept the offer, and engage an independent financial consultant to issue a professional opinion on the takeover offer. Additionally, the board is required to promptly announce the professional report and opinion of the independent financial consultant and any substantial changes to the terms of the takeover offer, if any (article 32). During the period of the takeover offer, the directors shall not resign (article 34), and the board of directors of the listed company shall not, without the approval of a shareholders' general meeting, dispose of the company's assets, make external investments, make adjustments to the principal business of the company, provide guarantees or loans, etc, which will have a significant impact on the assets, liabilities, interests or business results of the company (article 33).

In the event that a management buyout offer was made, the Takeover Measures only stipulate that, in general, the listed company shall have a proper and well-functioning organisational structure and an effective internal control system, but no compulsory rules regarding the composition of a special committee for approval of the buyout offer are provided. Notwithstanding the foregoing, the Takeover Measures heighten and stress the role of independent directors when considering a management buyout: the ratio of independent directors on the board must meet or exceed half; and the management buyout in question must be approved by two-thirds or more of the independent directors before it may be presented at the shareholders' general meeting for further discussion and approval.

Private offering of shares by a listed company

According to Implementing Rules for Private Placement of Shares by Listed Companies (Revised in 2017) (the Rules), the board of directors, together with controlling stakeholders or other controlling persons, including supervisors, senior management and professionals engaged in the private offering, are required to act with due diligence and are forbidden from seeking improper gains related to the private offering. Further, they are forbidden from disclosing inside information, conducting inside trading or manipulating the trading price by using the inside information (article 3).

In particular, the board of directors is entitled to do the following:

- make decisions regarding the pricing benchmark date(article 9);
- approve the private offering through board resolutions (article 11); and
- determine the specific issuance objects':
  - name;
  - subscription price or pricing principle;
  - subscription quantity or quantity zone; and
  - restricted share trade period.

Furthermore, the conditional share subscription contract for the issuance shall be approved by the board of directors (article 13). Finally, the board of directors shall prepare the plan for the private offering in accordance with certain requirements and publish such plan as an attachment to the board resolutions (article 14).

The Administrative Measures for the Issuance of Securities by Listed Companies (effective 8 May 2006) provide that a listed company may not make a private offering if:

- any existing director or member of senior management of the listed company has received any administrative punishment by the CSRC within the past 36 months or has been publicly censured by the stock exchange within the past 12 months; or
- the listed company or any of its existing directors or senior management are under judicial investigation for any suspected crime or are being investigated by the CSRC for any suspected violation.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Disclosure requirements related to takeover of a listed company

The Takeover Measures impose disclosure requirements upon both the acquirer (including persons acting in concert with it) and the listed company. Much like Securities and Exchange Commission requirements in the US, the acquirer must prepare a report on its change in interests after it has obtained 5 per cent or more of the listed company's total issued shares, after which the acquirer must promptly submit such report to the CSRC, the relevant exchange and notify the listed company. The acquirer must follow this process each time its interests in the listed company increase or decrease by 5 per cent of more of the list company's total issued shares. The report will be disclosed and published on the bulletin of the exchange, and such report may be in a simplified (holding between 5 and 20 per cent interest of the listed company) or detailed (if the acquirer's shareholding is between 20 and 30 per cent) form in accordance the shareholding percentage of the acquirer immediately before it is required to generate such report. A simplified report shall include basic information about the following:

- the acquirer and persons in concert with it;
- information about the listed company;
- the purpose of the shareholding change;
- whether the acquirer intends to increase or decrease its shareholding by 5 per cent or more in the next 12 months;
- brief trading information related to the latest shareholding change; and
- prior trading information (within six months) of the listed company's shares.

Additional disclosures may include information relating to the size, origin and use of funds for trading by the acquirer on the listed company's shares, controlling structure of the acquirer, existence of and information regarding competition and related-party transactions between the acquirer and the listed company. Follow-up plans about the listed company or its business or assets are required for a detailed report. The listed company and its board of directors shall assume their obligation to properly investigate the above matters and make timely disclosure if they notice any abnormal or significant change of interest in the listed company.

Where an acquirer, with its shareholding in a listed company reaching or exceeding 30 per cent through securities transactions on the exchange, continues to increase its shareholding, such acquirer is legally required to propose a takeover offer, general or partial. Under this circumstance, the acquirer shall prepare a report on the takeover offer in the requisite form and make disclosures from time to time related to the report or any update thereto. The board of directors and an independent financial adviser must disclose an opinion regarding the takeover.

Disclosure requirements related to private offering of shares by a listed company

Given the nature of a private offering, a relatively low standard of disclosure applies when compared with the standard required for takeover of a listed company: the listed company and its board of directors need only disclose the private offering within two trading days after the board meeting approving the private offering, together with a plan on such private offering generated in accordance with the Rules.

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5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The Takeover Measures also provide time requirements that should be followed by the acquirer and the company in general.

Where an acquirer proposes to obtain 30 per cent or more shares of a listed company, the acquisition shall be carried out in the form of a takeover offer, and the offeror shall make an indicative announcement accompanying a summary of the takeover offer report within three days of the conclusion of a takeover agreement or similar transaction.

Within 60 days of the indicative announcement date, the offeror shall issue the takeover offer report; otherwise, the offeror shall notify the target company and make an announcement for the pending takeover offer report on the working day following the expiry of the 60-day period, and shall make this once every 30 days up until the announcement of the takeover offer report.

The board of directors of the target company shall announce a report with the professional opinion of the independent financial consultant within 20 days from the announcement of the takeover offer report by the offeror.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

According to the Takeover Measures, in general, a shareholders' meeting or vote is not required for a takeover offer of a listed company; thus, a dissenting shareholder has few options for objecting to the transaction except for refusing the offered purchase price.

On the other hand, when a management buyout offer is proposed, approval of the shareholders' general meeting with a simple majority of votes held by non-related shareholders present must be obtained. This provides an opportunity for the dissenting shareholders to challenge or even block the buyout. Under such circumstance, it would be natural for the acquirer (ie, the management) to offer an ideal price for the buyout and to draw support from independent directors and unrelated shareholders as much as possible.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

In addition to the ordinary provisions of a share purchase agreement or equity transfer agreement, listed below are certain provisions that are specific to general private equity transactions in China.

Valuation and readjustment

Usually, the valuation of the subject equity can be equally reflected by the payment clause. However, it is advisable to require the inclusion of an explicit valuation clause when the parties are contemplating a valuation readjustment agreement for the sake of comprehensibility and coherence.

Specific representations related to compliance with State Administration of Foreign Exchange (SAFE) rules

In China foreign exchange is strictly controlled. Therefore, when a private equity transaction involves foreign currency exchange or money flow over national boundaries, in order to ensure that the investors' profit can be remitted smoothly in the future, it is advisable to pay special attention to the seller and the target company's compliance with the rules issued by the SAFE.

Closing arrangement

See question 20.

Breach, indemnification and liability limitation

Occasionally, private equity investors ask for special breach remedies and indemnifications for their investment from the target company. This is because these financial investors seldom participate in daily management and operation of the company and they are bound by internal return rate requirements. However, investors should note that if such remedies or indemnifications are subject to PRC law, punitive damages and similar actual or foreseeable losses of the claimant may not be recognised by the court.

Full time service and non-compete

These provisions are typically used in venture capital investments. The founder and his or her team are the most valuable resource in early-stage companies; thus, the investors must secure full time and exclusive services of the team on the books and in practice.

Preferred rights and management rights

Preferred rights are common to private equity transactions and may vary slightly on a case-by-case basis. These rights usually include, among others, right of first refusal, right of co-sale, anti-dilution rights, pre-emptive rights, drag-along rights, management rights and, most importantly, right of redemption and liquidation preference.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

The senior management, including the board of directors, plays a significant role in a company's operation and governance, especially in a listed company. As mentioned in question 3, in the event of a takeover offer the board of directors of a listed company is empowered to adopt appropriate actions against the takeover offer and it may, together with an independent financial consultant, analyse offer terms and the credibility of the acquirer, thus, providing shareholders with a suggestion of whether to accept such offer. Additionally, while certain restrictions may exist, the board of directors and senior management will continue to keep, control and manage the listed company until a new board is formed after consummation of the acquisition. From this perspective, senior executives not only participate in the acquisition, they and their suggestions and decisions are able to influence completion or rejection of the acquisition transaction.

Employee incentive planning has become increasingly common in China. The significant value and surplus of share equity tends to be more attractive than an ordinary salary and subsidy to senior management and other key persons of a company. The incentive package of listed companies in China is still very underdeveloped compared with the practice in the US. It is expected that PRC laws and companies alike will accept more flexible and varied types of employee incentive packages soon, while more efficient and reasonable regulations develop at the same time.

It is advisable for private equity sponsors to discuss management participation as soon as practicable, so long as they expect to maintain the original management and stabilise the target company for subsequent arrangements.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Income tax is the primary concern for participants in private equity transactions. Under PRC tax law, a general 25 per cent income tax applies to all resident companies (ie, companies that are incorporated in PRC or incorporated overseas with major management located in China); and foreign companies shall pay 20 per cent (reduced to 10 per cent, temporarily) of the profit from disposing of equity in domestic companies or other assets like real estate or land-use right as withholding income tax. It is worth mentioning that venture capital enterprises that have invested in non-listed high-tech small and medium enterprises and held the equity for no less than two years may enjoy an income tax deduction of up to 70 per cent of their investment amount.

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It is worth noting that, according to a circular issued by the State Administration of Taxation on 3 February 2015, if a foreign investor disposes of shares in another foreign company that directly or indirectly holds Chinese taxable assets, and such transfer has a similar effect to directly transferring these Chinese assets, then any gains attributable from the disposal will be subject to Chinese income tax (at the rate of 10 per cent), provided that the manner of disposal does not have a bona fide commercial purpose other than the avoidance of Chinese income tax. Inevitably, this requirement has profoundly impacted the tax costs of offshore companies (including the red-chip structure adopted by Chinese companies or individuals) as well as the design of investment structures, structuring of transactions and selection of exit plans.

For an individual, interests, dividends, bonuses received and the income from transfer share equity or other rights are subject to a 20 per cent individual income tax, while income from wages and salary is subject to progressive tax rates ranging from 3 to 45 per cent. Executive compensation plans and employee incentive plans, whichever form is used, will be regarded as income from wages, and salary and the progressive income tax applies.

Stamp duty is also relevant for private equity transactions. The transferor of shares and securities on the exchange or other trading entity has to pay a stamp duty, currently at the rate of 0.1 per cent.

Under PRC tax law, it is not economical for share acquisitions to be classified as asset acquisitions, because an additional VAT will apply to the transaction. The applicable tax rate varies from 6 to 17 per cent in most cases according to the target asset type.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Leveraged buyouts (LBOs) are not commonly utilised in China, partly because of the underdeveloped regulatory scheme facilitating such transactions and, more importantly, because high yield bonds, the typical tool used in LBOs, are not popular in the market. In China, a company usually has to rely on commercial banks when seeking large-scale financing and securities, or third-party guarantees also need to be provided. As for other private equity transactions, particularly venture capital investments, bridge loans are often used to provide short-term cash flow for the target during its negotiation with the investors.

The existing indebtedness will usually have direct adverse effects on the target company's preliminary valuation. Moreover, indebtedness, if inefficiently managed, may restrict the target's cash flow and its ability to obtain future financing.

The Company Law imposes the following general restrictions on companies and management when granting security for debt financing.

Article 16: where a company provides guarantee for others, a resolution of the directors or the shareholders, as applicable in accordance with the company's constitutional documents, is required, and limits stipulated therein shall be obeyed. It is legally compulsory to obtain the approval of a shareholders' meeting in case the company is to provide a guarantee for its shareholders or its actual controlling person.

Article 121: where a listed company provides a guarantee that exceeds 30 per cent or more of its assets in a year, a resolution of the shareholders' general meeting passed by two-thirds of shareholders present shall be obtained.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

On the one hand, as mentioned above, the CSRC has not yet implemented the registration system, and the current CSRC approval process for an applicant to conduct an IPO in China is time-consuming and costly. Therefore, the listing entity (even as a shell company) is very valuable, and few listed companies choose to take going-private transactions. On the other hand, LBO is not commonly accepted or used in going-private transactions in China owing to the absence of supporting regulations in connection with LBO and immature capital markets within China.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

In leveraged transactions, fraudulent conveyances are an issue to which the buyer should pay special attention. For example, the seller may conceal, or make misrepresentations regarding, any activities that may impede the normal process of the leveraged transactions, including defects of equity holding in the target company, large quantities of debt owed by the target company, transfer of the target company's assets for less than fair consideration and fabricated financial performance records. Therefore, the buyers will usually complete legal, financial and other due diligence investigations on the business of the target company to their satisfaction prior to the closing of the transactions. Furthermore, the sellers will be required to make representations and warranties and undertake post-closing indemnifications for breaches of such representations and warranties. Payment schedules related to the transactions may also be required to be extended (eg, last escrow payment is not made until 12–18 months after the initial closing) to cover any unexpected liabilities revealed after closing. In addition to the covenants in the transaction documents, confirmation letters on some significant facts and key issues should be delivered to the sellers to reduce the risks of the transactions.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Certain provisions are usually included in a shareholders' agreement to protect private equity firms with minority investments; for example the following:

- the founders are required not to transfer any equity of the target company directly or indirectly owned by them without the prior written consent of the private equity firms;
- private equity firms are usually entitled to appoint directors or observers of the target company;
- private equity firms and the directors appointed by them may have veto rights to some specific matters that affect the rights or interests of the private equity firms; and
- provisions on investor rights and privileges, including pre-emptive rights, rights of first refusal and co-sale, drag-along rights, dividend preference rights, liquidation preference rights, redemption rights, anti-dilution rights, which may effectively protect the interests of the private equity firms.

The Company Law also provides several legal protections for minority shareholders, including the following:

- any shareholder is entitled to consult and copy the articles of association, minutes of meetings of the board of shareholders, resolutions of meetings of the board of directors, resolutions of meetings of the board of supervisors and financial reports, and may request to consult the accounting books of the company (article 33);
- any shareholder who votes against the relevant resolution of the board of shareholders may require the company to purchase his or her equity at a reasonable price under several circumstances, including the following:
    - where the company has not distributed any profits to the shareholders for five consecutive years, but has made profits during such period and conforms to the profit distribution requirements of the law;
    - in the event of any combination, division, or transfer of the principal assets of the company; or
    - where the business term specified in the articles of association expires or any of the other grounds for dissolution prescribed in the articles of association is satisfied, and the meeting of the

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board of shareholders continues the company's existence by modifying the articles of association through adopting a resolution (article 74);

- where the procedures for calling a meeting of the board of shareholders or general meeting, or a meeting of the board of directors, or the voting method used therein violates any law, administrative regulation or the company's articles of association, or where any resolution violates the company's articles of association, the shareholders may, within 60 days of the date on which the resolution is passed, petition a people's court to nullify it (article 22); and
- where any director or senior officer damages the shareholders' interests by violating any law, administrative regulations, or the articles of association, the shareholders may initiate a legal action in the people's court (article 152).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

There are two main methods for acquisition of listed companies in China: tender offers and agreed acquisitions. Pursuant to the Securities Law of the PRC and the Takeover Measures, in the event that a purchaser holds 30 per cent of the issued shares of a listed company through securities transactions at stock exchanges and wishes to further increase the shareholding, such purchaser should issue either a general or partial tender offer to the target company. Furthermore, the management of the target company may take anti-takeover measures for the benefit of the company to prevent or frustrate the acquisition of the company and to prevent transfer of control.

In September 2016, the CSRC amended the Administrative Measures for the Material Asset Reorganization of Listed Companies (Administrative Measures) with the aim of imposing stricter requirements on reverse takeovers of public companies (or backdoor listings). The main changes for backdoor listings under the Administrative Measures include the following:

- improving the criteria and requirements for defining backdoor listings, as follows:
  - the previously used single indicator of 'total amount of assets' has changed to five indicators (total amount of assets, operating revenue, net profits, net assets and share capital), so that if any one indicator reaches the 100 per cent threshold, the transaction will constitute a backdoor listing and will be subject to standard IPO approval procedures;
  - a new requirement has been added, providing that a proposed transaction will constitute a backdoor listing if the core business structure of the company in question will be changed; and
  - the definition of a change in control has been expanded to situations 'where the equity is dispersed, but the directors and senior management can direct the material financial and operating decisions of the company, it will nevertheless be deemed to have control'; and
- adding restrictions on public shell companies, as follows:
  - if a listed company has violated any laws or regulations in the past three years, received an official reprimand by the exchange in the past year, or committed a significant integrity damaging act, it will not be permitted to sell a shell company;
  - listed companies engaging in backdoor listings may not raise part of the supporting funds while in the process of a backdoor listing transaction; and
  - the lock-up period has been extended to 36 months for the following:
    - original actual controllers;
    - affiliated parties controlled by the actual controller of the listed company; and
    - any entities or individuals that directly or indirectly acquire the shares of the listed company transferred by the above individuals or entities in the process of a backdoor listing transaction (the lock-up period of new small shareholders has been extended to 24 months).

According to the Anti-Monopoly Law of the PRC (promulgated 2007 and effective 1 August 2008) (the Anti-Monopoly Law), when the concentration of operators reaches certain standards, as regulated by the State Council, such operators should submit a report to the anti-monopoly enforcement authorities of the State Council prior to the concentration. Concentration of operators include the following circumstances:

- operators merger;
- one operator obtains controlling rights in another operator by means of equity or asset purchase; and
- one operator, by means of contract, obtains controlling rights in another operator or can exercise decisive influence on another operator.

Any required review processes under the Anti-Monopoly Law may affect the private equity firm's ability to complete the transactions.

For issues related to mergers and acquisitions (M&A) of domestic enterprises involving foreign capital, see question 18.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

There are three main exit strategies for private equity firms, as follows:

- seek an IPO;
- equity transfer, including management buyout and M&A; and
- bankruptcy and liquidation events.

As the approval process for a portfolio company to conduct an IPO in the Main Board Market is strict, time-consuming and costly, many private equity firms choose the National Equities Exchange and Quotations (NEEQ), which is not limited to high-tech companies and does not restrict the nature of shareholders' ownership. However, recently the NEEQ has seen a significant drop in share prices by its listed companies for various reasons, such as low levels of liquidity, limitations on share transfers, etc. The NEEQ, once dubbed the Chinese version of NASDAQ, has lost its appeal to many companies seeking to attract investment from capital markets.

Pursuant to the Business Rules of National Equities Exchange and Quotations (for Trial Implementation) (revised 2013 and effective 30 December 2013), a joint stock limited company applying for a stock listing on NEEQ should meet the following conditions:

- the company should have been duly established and validly existed, in accordance with laws and regulations, for at least two years. Where a limited liability company changes to a joint stock limited company, based on its original book value of net assets converted to shares in an overall manner, the duration of time in existence can be calculated from the date of the limited liability company's incorporation;
- the company should have clear business and continuing operation abilities;
- the company's corporate governance mechanisms are sound, and its operations are legal and standard;
- the company should have clear equity holding and structure, and it must issue and transfer stocks in accordance with relevant laws and regulations; and
- the company should be recommended by and subject to continuous supervision of the sponsoring brokers.

In case of a sale of a portfolio company by private equity firms, buyers may usually seek fairly extensive representations and warranties and post-closing indemnifications for breaches of such clauses. However, as the private equity firms are usually financial investors and do not participate in the daily operation of the target company, they will not make any representation and warranties to the buyer, other than with respect to the ownership of its shares in the target company. In order to facilitate the transfer of equity by the private equity firms, founders of target companies may be required to make certain representations to potential buyers regarding the overall operational status of the portfolio company.

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16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

The provisions regarding investor rights and privileges should terminate upon the closing of an IPO. Basic rules of corporate governance are stipulated in the Rules of Corporate Governance of Listed Companies (effective 7 January 2002), which provide that the corporate governance structure of a Chinese listed company must ensure that all shareholders receive fair treatment, especially minority shareholders, and all shareholders of listed companies should enjoy equal rights and bear corresponding obligations based on the shares they hold. Pursuant to these rules, among other things, listed companies of which more than 30 per cent shareholdings are owned by controlling shareholders should adopt a cumulative voting system in shareholders' meetings for the election of directors.

There are several provisions on lock-up restrictions related to an IPO in the Main Board Market, including the following:

- the issuer cannot transfer his or her shares within one year from the date of IPO if such shares are held by the issuer before the IPO;
- the controlling shareholder cannot transfer or have the issuer buy back his or her shares within three years from the date of the IPO if such shares are held by the controlling shareholder before the IPO;
- any share issued prior to any public offer of shares cannot be transferred within one year of the date on which the shares of the company are first listed and traded on a stock exchange; and
- directors, supervisors and senior officers of the company cannot do any of the following:
  - during their respective terms of office, transfer more than 25 per cent of the total shares they hold in the company each year;
  - transfer any of the shares within one year of the date on which the shares are first listed and traded on a stock exchange; or
  - transfer any of their shares within six months of the date on which they ceased to hold a post in the company.

Sale on the secondary capital market is the common method for private equity sponsors to dispose of their stock in a portfolio company following its IPO. Subject to certain thresholds, share issuances of a listed company must be properly disclosed in advance. Sometimes, a stock exchange may send enquiry letters to a listed company requesting an explanation or supporting documentation for large-scale share issuances.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Considering the time-consuming approval process for a company to be listed in China, few listed companies choose to take going-private transactions. However, there are several listed special vehicles, which are actually controlled by Chinese residents or Chinese resident enterprises, taking going-private transactions overseas. These targets of going-private transactions are mainly in internet and media industries, such as Focus Media Holding, Qihoo 360 Technology, Youku.com Inc, Jumei International Holding Limited and Zhaopin Limited.

The Foreign Investment Industrial Guidance Catalogue (the Catalogue) (effective 28 June 2017) classified industries for foreign investment into three categories: encouraged, restricted and prohibited (see 'Update and trends'). Compared with the 2015 edition of the Catalogue, which defined four categories, the allowed category was combined with the encouraged category. Moreover, there are now fewer restrictions over certain industries, such as the general service and manufacturing sectors. A negative list, developed on a trial basis in certain free-trade zones, has now been adopted nationwide.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Cross-border transactions

The following issues are unique to cross-border transactions in China:

Foreign investment restrictions

As mentioned in question 17, the Catalogue provides several foreign investment restrictions. Therefore, a foreign company's direct investment or M&A should not result in violation of the provisions of the Catalogue on restricted and prohibited industries for foreign capital.

Anti-monopoly review

As mentioned in question 14, acquisitions of domestic enterprises involving foreign capital may also be subject to consolidation review pursuant to the Anti-Monopoly Law.

National security review

A foreign company's M&A activity may be subject to national security review. In February 2011, the State Council promulgated Circular 6 (effective 3 March 2011), a notice on the establishment of a security review system for M&A of domestic enterprises by foreign investors. The Ministry of Commerce of the PRC (MOFCOM) promulgated the MOFCOM Security Review Rules on 25 August 2011, which became effective on 1 September 2011. According to Circular 6 and the MOFCOM Security Review Rules, national security review is required to be undertaken in order to complete M&A as follows:

- by foreign investors of enterprises related to national defence; and
- through which foreign investors may acquire de facto control of a domestic enterprise that could raise national security concerns.

When determining whether to subject a specific merger or acquisition to a national security review, MOFCOM will look at the substance and actual impact of the transaction. Bypassing national security review by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions by foreign investors is prohibited. In addition, even if a merger or acquisition by foreign investors is not currently subject to national security review, or is determined to have no impact on national security after such review, it may still be subject to future review. A change in conditions (such as change of business activities or amendments to relevant documents or agreements) may trigger the national security review requirement, then the foreign investor to the merger or acquisition must apply for relevant approval with MOFCOM.

Outbound investment

The following issues are unique to outbound investment by Chinese companies:

National Development and Reform Commission (NDRC) and MOFCOM approval/registration

Overseas investments involving sensitive countries (regions) or industries are subject to NDRC and MOFCOM approval/registration. MOFCOM rules on overseas investments define 'sensitive countries and regions' as those that have not established diplomatic ties with China or that have been sanctioned by the United Nations. 'Sensitive sectors' are defined by MOFCOM as industries pertaining to export-restricted products and technologies or industries involving interests of more than a single nation or region. The NDRC does not define 'sensitive sectors', but lists examples, such as basic telecommunications, cross-border utilisation of water, large-scale land development, main electricity transit lines, electricity grid, news and media sectors.

Other overseas investments not involving sensitive countries or industries are only required to conduct NDRC and MOFCOM record filings.

Road Pass regime

A Chinese company conducting an overseas bid or acquisition of US$300 million or more must obtain a confirmation letter from the NDRC before commencing any 'substantive work' on such transaction (including signing a binding agreement, making a binding offer or applying for approval from foreign government agencies). Otherwise,

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Update and trends

Record-filing system for foreign M&A

On 8 October 2016, MOFCOM released the Interim Measures for Record-Filing Administration for the Establishment and Change of Foreign-Invested Enterprises (the Record-Filing Measures), which have changed China's foreign investment administration system from an approval regime to a record-filing regime. After the Record-Filing Measures' release, except for industry sectors with specific equity ownership and senior executive requirements set out in the Catalogue (Specially Administered Industries), and some foreign M&A transactions, foreign investments in China and changes to foreign-invested enterprises must only be filed for the record, rather than approved.

On 30 July 2017, MOFCOM issued the Decision on Revising the Interim Administrative Measures for Record-Filing of Incorporation and Changes of Foreign-invested Enterprises (the Record-Filing Revisions). Under the Record-Filing Revisions, the following foreign M&A transactions will only be subject to record filing:

- mergers and acquisitions of non-foreign-invested companies in China by foreign investors; and
- strategic investments in listed companies by foreign investors.

Before the Record-Filing Revisions, all types of foreign M&A were subject to MOFCOM approval, which took one month or more to complete. After the Record-Filing Revisions, a large volume of foreign M&A transactions became subject to a record-filing system, which only requires that an Application Form for Incorporation or Application Form for Change be completed and uploaded along with certain other materials to the integrated management system implemented by MOFCOM.

The most significant change under the Record-Filing Revisions is the simplification of application materials and decreased processing time. For instance, for an equity acquisition of a domestic company by a foreign investor, the approval system previously required applicants to submit asset or equity valuation reports and the preceding financial year's financial audit report of the domestic target company. Under the record-filing system, however, applicants need only provide the assessed value, the reference number of the financial audit reports and indicate if any companies invested by the target company are subject to Specially Administered Industries in the Application Form for Incorporation. The processing time has also been decreased from around 30 days or more (for approval) to a prescribed processing period of only three days after all required materials have been uploaded.

Outbound investment development

On 18 August 2017, the State Council publicly promulgated the Directive Opinion on Further Guiding and Regulating Outbound Investment (the Directive Opinion), which was issued on 4 August 2017 jointly by the NDRC, MOFCOM, the Ministry of Foreign Affairs and the People's Bank of China. The Directive Opinion introduced a negative list into outbound investment by expressly creating three categories of outbound investment: encouraged, restricted and prohibited:

- the encouraged category includes six categories of outbound investment, including those related to the One Belt, One Road initiative, the promotion of China's export of products and technology and the expansion of China's financial institutions overseas;
- the restricted category includes five categories of outbound investments, real estate, hotel, theatre, sports clubs and other entertainment sectors, as well as the establishment of private equity investment funds or investment platforms without specific industrial projects. All investment in the restricted category are now subject to approval by government authorities (as opposed to a standard record filing); and
- the prohibited category includes five categories of outbound investment that are forbidden without special state approval, including the export of core technologies and military industry products, and outbound investment that uses technologies, processes or products prohibited from export from China, including sectors such as gambling and pornography.

The promulgation of the Directive Opinion makes the specific categorisation of an outbound investment project of crucial importance. To date, however, the classifications under the Directive Opinion remain somewhat vague and discretionary, as no specific list of industries has been provided.

It is also worth noting that the NDRC issued the Announcement on Seeking Public Comments on the Administrative Measures for the Outbound Investment of Enterprises on 3 November 2017 (the Administrative Measures Draft). The key change under the Administrative Measures Draft is the proposal to cancel the Road Pass regime. Currently, a Chinese company conducting an overseas bid or acquisition of US$300 million or more must obtain a confirmation letter from the NDRC before commencing any 'substantive work' on the transaction (including signing a binding agreement, making a binding offer or applying for approval from foreign government agencies). Cancellation of the road pass requirement will reduce uncertainty and should increase the flow of outbound investment.

the NDRC will circulate a notice of criticism, request the company to make rectification or even impose penalties. The confirmation letter is called the 'Road Pass' in practice, which gives the NDRC discretion to determine which Chinese entity has the right to pursue a particular overseas transaction where there is more than one company competing for the same overseas investment.

Starting from October 2016, the PRC government adopted a more stringent policy to regulate overseas investment. Many outbound M&A projects failed to obtain the NDRC road pass, allegedly owing to their failure to meet certain financial performance standards, although those standards were never publicly disclosed. After the CPC 19th National Congress, the NDRC issued draft measures seeking public comments to ease outbound investment. To date, however, any new policy changes to promote outbound investment remain pending.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

It is not uncommon for more than one private equity firm to participate in a club or group deal for purposes of sharing investment risks, making bigger transactions, introducing different resources, or other reasons. However, standards for investment terms and conditions may vary among the different private equity firms. Valuation of the target company and investment amounts of each private equity firm may be a key issue to be addressed in a club or group deal.

Furthermore, the investor rights and privileges should be attributed to and allocated among private equity firms generally based on respective post-closing ownership percentages, including rights to appoint directors or observers (or both), voting rights and veto rights, information and inspection rights, pre-emptive rights, rights of first refusal and co-sale, drag-along rights, dividend preference rights, liquidation preference rights, redemption rights and anti-dilution rights.

In addition, some private equity firms may have their own special transaction clauses, which may be in conflict with those of others. This could lead to more necessary coordination and negotiation among the parties to the deal. That said, usually the lead investor (typically the investor making the largest cash payment to the company) will set the basic investor rights when negotiating with the company and founder. Other co-investors generally do not require any additional preferential treatment than that of the lead investor.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

In order to seek more certainty of closing, several provisions are often specified in a share purchase agreement, as set out below.

Exclusivity

From the date of execution of the share purchase agreement until the closing of the transaction, the seller is usually required not to, and not to permit any of its representatives to, solicit, initiate, facilitate, engage in any discussions or negotiations with respect to adoption, approval,

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commitment to, or conclusion of, any investment transaction with, or any sale of the business or equity thereof to, any third party, whether directly or indirectly.

Closing precedents

The obligation of the private equity buyer to pay an investment amount at the closing is subject to the fulfilment and satisfaction or waiver of several conditions by the private equity buyer, including the following:

- the representations and warranties made by the seller should be true, correct and complete when made and as of the closing;
- all approvals of any competent governmental authority that are required to be obtained by the seller in connection with the consummation of the transactions should have been duly obtained prior to and be effective as of the closing;
- the private equity buyer's legal, financial, technical and intellectual property due diligence investigation and other investigations on the business of the target company should have been completed to its satisfaction;
- no event should have occurred that would have a material adverse effect on the target company, or its businesses, operations, assets or other financial conditions; and
- the competent committee of the private equity buyer should have approved the execution of the transaction documents and the transactions contemplated thereby.

Termination rights

Prior to the closing of the transaction, an executed share purchase agreement may be terminated by the private equity buyer if the closing has not occurred within a certain period of time after executing such agreement, or if there has been a material misrepresentation or material breach of a covenant contained in such share purchase agreement.

Termination fees

Upon termination of the transactions not solely owing to a fault of the private equity buyers, the target company may bear all of the legal, financial, administrative and other costs and expenses incurred in connection with financial, legal and business due diligence and the negotiation, execution, delivery and performance of the share purchase agreement and other transaction documents.

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Colombia

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity transactions in Colombia usually involve buyouts (cash-outs) or recapitalisations (cash-ins), or a combination of both, with the objective of turning the relevant portfolio company around. Turnarounds are usually sought by both providing capital for growth and instilling best management and governance practices in the relevant target portfolio companies (which are typically family-owned, informally managed and with limited access to financing) aimed at unlocking the target's growth potential.

It is not uncommon for the original owners to retain a partial interest in the target portfolio company, so private equity transactions in Colombia may also involve shareholders' agreements regulating the governance of the company and the rights and obligations of the parties with respect to their shares.

Going-private transactions are extremely rare, because the typical Colombian target portfolio company is not listed on the stock exchange. In fact, mergers and acquisitions activity in Colombia is dominated by private transactions, as only a handful of transactions involve listed companies (in the past four years only 16 public tender offers took place).

The acquisition structures of private equity transactions are mostly tax-driven, usually structured with an indirect sale exit strategy in mind (ie, at exit, the private equity shareholder will sell the shares of an offshore holding vehicle, and not the shares of the portfolio company), because, in principle, indirect sales of shares in Colombian companies are not taxed in Colombia. The jurisdiction of the offshore holding vehicle will be chosen on the basis of several considerations, including the Colombian double taxation treaty network.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The typical Colombian target portfolio company is privately held, so corporate governance rules applicable to these companies are significantly less stringent than those applicable to public (ie, listed) companies.

When the target is a listed company (which, as mentioned above, is the exception) there are incentives to taking it private prior to the acquisition (delisting is sometimes a condition precedent to the acquisition) in order to avoid a mandatory public tender offer, or soon after the acquisition, in order to avoid corporate governance rules (which require a minimum number of independent directors) or special disclosure requirements.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Going-private transactions are extremely rare, because the typical Colombian target portfolio company is not listed on the stock exchange. In any case, under Colombian law the decision to sell shares of public companies lies exclusively with the shareholders, and the board of directors does not play a formal role in the process.

However, in practice, access to the information required by the purchaser is made possible through the management of the company. The information that shareholders have the right to access directly, regardless of the size of their stake and whether or not they control the target, is limited to the financial statements, main accounting books and minute books, only 15 days before the annual meeting. Therefore, the selling shareholders must persuade (or otherwise prevail over) management to make the information available to the bidder. This will sometimes prompt complaints by other, non-selling shareholders, that the controlling shareholders are being afforded preferential treatment.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

As explained in question 6, going-private transactions imply carrying out a public tender offer addressed to all shareholders that either voted against the delisting or did not attend the shareholders' meeting where the delisting was approved. Public tender offers are subject to special disclosure rules.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The timing aspects of a typical acquisition also apply to private equity transaction and usually consist of antitrust clearance and, if the target is a public company, a mandatory public tender offer.

Antitrust clearance

Antitrust clearance is required if the transaction involves all of the following elements:

- unrelated parties are engaged in the same economic activity with regard to a sector of production, supply, distribution or consumption of a given article, raw material, product, merchandise or service in Colombia;
- the parties establish a horizontal relationship, or participate in the same chain of value, establishing a vertical relationship; and

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- turnover or total assets of the parties from the previous fiscal year, individually or combined, exceed the annual thresholds established by the Superintendency of Industry and Commerce (SIC), the competition authority. For operations undertaken in 2018, the thresholds are set at the peso equivalent of 100,000 minimum monthly wages (in Colombia the minimum wage is often used as an index, in order to maintain thresholds), so for antitrust clearance purposes the applicable monthly wage is 781,242 pesos so the peso threshold figure would be a little under 78.124 billion pesos.

When the combined market share is below 20 per cent, the parties can apply for an abbreviated notification procedure. In this case, the transaction is deemed as authorised on filing of a mere notification to the SIC by the parties.

If the percentage exceeds 20 per cent, the transaction must be expressly cleared by the SIC. The time frame for clearance depends on the complexity of the competition issues triggered by the transaction, but on average can take from three to six months.

Public tender offer

Public tender offers are mandatory when the following exists:

- any person (or group of persons sharing the same beneficial owner) intends to acquire shares representing 25 per cent or more of the voting shares of a company registered at a Colombian stock exchange;
- any person (or group of persons sharing the same beneficial owner) who already owns 25 per cent or more of the voting shares of the relevant company intends to increase its voting shares by more than 5 per cent;
- any person (or group of persons sharing the same beneficial owners) acquires voting shares representing 25 per cent or more of the target company as a result of a merger, in Colombia or abroad (in which an 'ex-post' public tender offer must be launched within three months of the transaction, unless the purchaser divests the relevant shares within three months of the merger);
- any person (or group of persons sharing the same beneficial owner) holds more than 90 per cent of the shares of the relevant listed company, if the following is true:
  - this threshold was reached by means other than a public tender offer for all of the shares in the company; and
  - the minority shareholders owning at least 1 per cent of the voting shares of the target company request that a public tender offer is launched (in which case the public tender offer must be launched within three months of the date on which the 90 per cent threshold was exceeded); and
- the shareholders of the relevant listed company decide to delist the company by a majority shareholder vote (as opposed to a unanimous shareholder vote).

Any public tender offer must comply with the following requirements:

- the bidder must file a formal request before the Financial Superintendency of Colombia (SFC), with a draft of the notice of its intention to make the public tender offer, which must include the following:
  - the minimum and maximum number of shares that the bidder will accept (with at least a 20 per cent margin between the two figures);
  - the price at which the shares will be paid;
  - the date by which the offer must be accepted;
  - the name of the exchange broker to be used in the operation;
  - information on any pre-agreed terms; and
  - the bidder must also prepare and submit an offering memorandum for the SFC's approval with the following information (in addition to the information contained in the public tender offer notice):
    - name and principal place of business of the target company;
    - name, principal place of business and main corporate activity of the bidder;
    - information on shares that the bidder already has in the target company and any prearranged transactions or other agreements between the bidder and the management of the target company or other shareholders;
    - a brief description of the tax, foreign exchange and foreign investment regimes applicable to the securities offered as payment (if applicable);
    - information on the methodology used to value the securities offered as payment (if any);
    - certificates by the bidder and its investment bank on the accuracy of the offering memorandum and information on authorisations to issue the offer; and
    - other information requested by the SFC.
- Once the above information is filed, the SFC must notify the Colombian Stock Exchange (BVC), in order to suspend the negotiation of the shares until the day after the publication of the public tender offer notice. The SFC has five days to make any comments it deems relevant;
- the public tender offer notice must be posted three times in the finance section of a national newspaper, the first within the five days following the expiry of the SFC's term to make comments to the draft public tender offer notice and offering memorandum; the other postings cannot be spaced more than five calendar days apart. The public tender offer notice must also be posted in the official information bulletins issued by the BVC, on each day from the date the public tender offer notice is first published until the day set for acceptances;
- the acceptances to the public tender offer must be made on the date set for that effect in the public tender offer notice, at a special two-and-a-half hour round of bidding, under an open outcry system. If the number of acceptances meets the minimum amount of shares indicated by the bidder, then all acceptances are deemed to be final. If not, the bidder is not required to purchase the shares (but may freely elect to do so);
- if more acceptances are received than the maximum offer was made for, then the right to sell shares is allocated proportionally among those who accepted; and
- the bidder must establish a performance guarantee, covering a certain percentage of the value of the transaction. The guarantee can be in the form of a stand-by letter of credit or a bank guarantee, among other options, and must be established before the public tender offer is launched.

The timeline for the public tender offer can be summarised as follows:

- submission of the application to the SFC;
- issuance of comments or expiry of the SFC's term to issue comments (five business days): eight days from the date of submission;
- publication of the first notice in a national newspaper (within five calendar days after the issuance of comments or expiry of SFC's term to issue comments): 13 days from the date of submission at the latest;
- the start date for receipt of acceptances (five business days from the publication of the first notice): 20 days from the date of submission;
- the deadline for the acceptance of the tender offer (a minimum of 10 and a maximum of 30 business days from the start date for receipt of acceptances): 35 days from the date of submission at the earliest; and
- delivery of target shares by selling shareholders and payment by purchaser: 38 days from the date of submission.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Under Colombian law, the decision to sell shares of public companies lies exclusively with the shareholders; it does not contemplate mechanisms where a purchaser, or the management or the board of the target company can compel dissenting shareholders to sell their shares.

In addition to refusing to sell its shares, a dissenting shareholder has the following protections:

- disclosure: agreements, in which one party (the bidder) agrees to launch a public tender offer and another party (the shareholder) commits to accept the public tender offer, must be disclosed to the SFC, the BVC and the market in general at least one month before the date on which they are to be perfected. This must include an indication of the main terms and conditions of the exchange or

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trading system of the transaction and the proposed date and time of the transaction;

- interference with the takeover bid: takeover bids in Colombia are regulated so that third parties (that is, parties that have not reached an agreement with the controlling shareholders) are given the opportunity to interfere with a public tender offer that has been launched by a bidder who has reached an agreement with the controlling shareholder, and submit competing bids; and
- public tender offer: although the decision to delist a company's shares simply requires a majority shareholder vote, the shareholders voting in favour of the delisting must carry out a public tender offer addressed to all shareholders that either voted against the delisting or did not attend the shareholders' meeting where the delisting was approved. The public tender offer must be carried out within three months of the shareholders' meeting. The delisting only becomes effective after the public tender offer is completed.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Purchase agreements for private equity transactions are usually very similar to purchase agreements for traditional acquisition transactions. However, some differences can be seen when a private equity buyer or seller is involved.

When the transaction involves a private equity buyer, the private equity buyer will be more aggressive than a typical strategic buyer in seeking that the seller's liability not be limited by the buyer's due diligence or disclosure by the seller. Thus, 'pro-sandbagging' clauses are not unheard of. A private equity buyer will also sometimes seek to subject completion of the transaction to the availability of financing, but in recent deals this has usually been rejected.

When the transaction involves a private equity seller the scope of representations and warranties is usually more limited than in agreements for traditional acquisition transactions, in matters such as the time span covered by the representations and warranties, the actual knowledge of the sellers and the survival of the representations and warranties after completion. Private equity sellers will also seek to limit indemnity obligations to amounts held in escrow (although this is becoming the market practice for all acquisition transactions).

Purchase agreements relating to listed companies are special, because the transfer of shares can only take place pursuant to a public tender offer through the stock exchange. In these agreements the prospective buyer's obligation is to launch a public tender offer on the pre-agreed terms and conditions, and the other party's (the selling shareholder's) obligation is to accept the public tender offer, if it meets the pre-agreed terms.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

While managers or directors remain employed by the target company, they must maintain their fiduciary duties with the company. Colombian law imposes obligations on 'administrators', including managers and directors, to act in good faith, not to misuse their position to advantage themselves or improperly use information of the company for their own gain. During negotiations, administrators who find themselves with a conflict of interest must not participate in such decisions.

Administrators have joint and several liability for the damage suffered by the company, shareholders or third parties as a result of their negligence and wilful misconduct, except where they had no knowledge of the act or omission, or voted against it and did not carry out such act. Any attempt to limit or exonerate administrators from such liability in the by-laws is null and void.

Therefore, administrators will need to analyse cases in which there may be a conflict of interest carefully and, when necessary, declare themselves disabled.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Private equity transactions in Colombia should be carefully analysed so as to benefit from any tax advantage available because of the type of asset, the situation of the company or the nationality of the parties. Colombia has double taxation treaties under the OECD guidelines in effect with Canada, Chile, the Czech Republic, India, Korea, Mexico, Portugal, Spain and Switzerland, and has signed treaties with France, Italy and the United Kingdom, which are still undergoing approval procedures. It is in the process of negotiating tax treaties with Belgium, Germany, Israel, Japan, the Netherlands, the United Arab Emirates and the United States. The Andean Community treaties (in force with Bolivia, Ecuador and Peru) also contain some double taxation provisions. Share acquisitions cannot be classified as asset acquisitions for tax purposes. This means that share deals have a different tax regime to asset deals.

Deductibility and financing costs

Although the cost of financing obtained for the acquisition of shares in Colombian companies is generally deductible, there are some limitations to the deductibility of interest. Colombian income tax law does not allow the deduction of interest paid on the amount of loans that, in average during the year, have exceeded a 3:1 debt to equity ratio if compared to the net tax equity of the taxpayer as of the end of the previous year. The debt will be determined as a weighted average of the borrowed amounts according to its duration in the fiscal year, under the methodology provided by the government. This limitation affects not only debts with foreign-related parties, but any debt that yields interest.

The deductibility of interest paid abroad is also subject to thin capitalisation rules, as well as the requirement that the relevant withholdings on interest are actually performed. Additionally, foreign exchange regulations should be complied with as a requirement for deductibility.

Interest payments made to foreign-related parties are also deductible under these same conditions, provided that the financing meets transfer-pricing regulations.

Withholding tax

As a general rule, interest paid on foreign loans is subject to a 15 per cent income tax withholding. Loans granted to Colombian financial institutions and certain loans related to foreign trade are subject to a zero per cent rate. Reduced withholding rates are available under double taxation treaties.

Dividends paid by a Colombian company to its shareholders (either resident or non-resident) are subject to withholding tax of 5 per cent for dividends paid to non-resident individuals and entities out of profits taxed at the corporate level and 35 per cent for dividends paid out of profits not taxed at the corporate level, plus an additional 5 per cent on the distributed dividend net of the 35 per cent initial tax.

Transfer taxes

The transfer of shares in a corporation (*sociedad anónima*) or a simplified stock company (*sociedad por acciones simplificada*) (the most common corporate structures in Colombia), is not subject to stamp or other transfer taxes. The transfer of shares in limited liability companies (*sociedades de responsabilidad limitada*) is subject to a registration tax of 0.7 per cent.

Income tax on disposal

It is common for private equity shareholders to try to structure their acquisitions so that they can dispose of them indirectly (by selling the shares of an offshore holding vehicle, and not the shares of the Colombian portfolio company), because, in principle, indirect sales of shares in Colombian companies are not taxed in Colombia. The jurisdiction of the offshore holding vehicle will be chosen on the basis

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of several considerations, including the Colombian double taxation treaty network.

Assuming the disposal is structured as a direct sale of shares of the Colombian portfolio company, the profits derived from the sale of the shares will be taxed at a rate of 10 per cent if the seller has held the shares for a minimum of two years, or at a rate of 34 per cent if the seller has held them for less than two years. The sale of shares of a listed company will not be taxed if the shares sold by the relevant shareholder within the relevant fiscal year represent less than 10 per cent of the issued and outstanding shares of the company.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Buyouts by private equity buyers are typically financed with debt. Debt financing will depend on the transaction and market conditions at the time. In principle, Colombian residents are allowed to freely obtain loans (domestic or foreign) to finance acquisitions.

Acquisition financing is usually obtained at the acquisition company level and then pushed down to the target by way of merger between the acquisition vehicle and the target.

Security is typically by way of a pledge of the target's shares, a guarantee by the target and a fixed and floating charge over the assets of the target. Putting this security package in place can be a challenge because security granted by the target can usually be put in place only after the acquisition closes, which means that the lender may be relatively unsecured for a brief moment (between disbursement of the loan and closing of the acquisition).

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Provisions relating to debt and equity financing are rare in Colombian private equity transactions. On occasion, when the original owners retain a partial interest in the target portfolio company, the relevant shareholders' agreement will establish limitations on the push-down of the debt and, in general, the target's debt to equity structure.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

There is no precedent in Colombia for this type of fraud in transactions involving leverage.

Transactions taking place within a certain time before a seller files for bankruptcy, or is placed under mandatory liquidation, are at risk of being revoked by the government or judicial authority overseeing the bankruptcy or liquidation. Transactions taking place when the seller has already filed for bankruptcy, or is under mandatory liquidation, will require the consent of the authority overseeing the bankruptcy or the liquidator.

These issues are usually handled by requiring consents from the target's main creditors, or setting up security (trusts) for the benefit of such creditors, as prior conditions to the completion of the transaction.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements entered into in connection with private equity transactions will typically regulate the governance of the company (business plans and annual budgets, special voting thresholds, anti-dilution protection, board composition and other minority protections) and the rights and obligations of the parties with respect to their shares (lock-ups, rights of first offer or first refusal) and options (drags, tags, puts and calls). These types of provision are valid and binding between the shareholders, but some of them may not be as regards the target portfolio company unless validly incorporated into the company's by-laws.

Regardless of whether a shareholders' agreement exists, a minority shareholder will always have the rights to:

- attend and vote at shareholders' meetings;
- challenge legal validity of shareholder decisions;
- review financial statements, main accounting books and minute books within the 15 days prior to the annual meeting;
- veto the conversion of the company into a different type of company;
- withhold approval required to avoid public tender offers;
- frustrate the adoption of decisions by unanimous written consent of shareholders (and directors); and
- frustrate the possibility of holding shareholder meetings outside the legal domicile of the company.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

See question 5 regarding the situations in which public tender offers become mandatory.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

The limitations on the ability of a private equity firm to sell its stake in a portfolio company are usually of a commercial or business nature, and rarely of a legal nature.

While many private equity transactions include the possibility of an IPO, and some shareholders' agreements even regulate the terms and conditions of an eventual future IPO in significant detail, IPOs remain extremely rare as an actual exit strategy. This is probably attributable to the relative immaturity of the Colombian securities markets.

When the transaction involves a private equity seller, the scope of representations and warranties is usually more limited than in agreements for traditional acquisition transactions, in matters such as the time span covered by the representations and warranties (sellers will attempt to limit this to the period they controlled the target), actual knowledge of the sellers and the survival of the representations and warranties after completion. Escrows are now commonplace and private equity sellers will also seek to limit indemnity obligations to amounts held in escrow.

This does not change if a private equity firm sells a portfolio company to another private equity firm (although negotiations are usually tougher).

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16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

IPOs or portfolio companies are rare in Colombia. Most of the stipulations that you would typically find in a shareholders' agreement relating to a private company could survive an IPO, but the enforceability of such an agreement regarding the portfolio company would likely be reduced as many of these provisions will not be capable of being validly incorporated into the company's by-laws.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Going-private transactions are extremely rare, because the typical Colombian target portfolio company is not listed on the stock exchange.

Targets in private equity transactions are typically family-owned, informally managed and with limited access to financing. Private equity firms invest in these targets with the objective of turning them around, by both providing capital for growth and instilling best management and governance practices.

Private equity transactions in Colombia have not focused on any particular industry, although in the past year we have seen an increase in transactions involving infrastructure, construction and real estate (including hotels and tourism).

Some representative private equity deals in the recent past include the following acquisitions:

- a significant minority stake in Bodytech (an operator of gyms) by Catterton and Teka Capital;
- a significant minority stake in LifeMiles (the entity that manages Avianca Taca's loyalty programme) by Advent International;
- Isagen (the second-largest electricity generator in Colombia), by Brookfield Asset Management; and
- a minority stake in Gas Natural SA E.S.P. (gas distribution and retail supply company), by Brookfield Asset Management.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Foreign investments are permitted in all areas of the economy with the exception of activities related to defence and national security, and the processing and disposal of toxic, dangerous or radioactive waste not generated in the country. A Colombian company can be 100 per cent foreign-owned, except for foreign investment in national broadcast television, which is limited to a maximum of 40 per cent ownership of the relevant operator.

Under the Colombian Constitution and foreign investment regulations, foreign investment in Colombia shall receive the same treatment as an investment made by Colombian nationals. The conditions for reimbursement of foreign investment and remittance of profits in effect at the time the investment is registered may not be changed so as to affect foreign investment adversely, except on a temporary basis when the international reserves are lower than the value of three months of imports.

Foreign investments in Colombia do not require prior government approval. They must be registered with the Central Bank either automatically upon the receipt of currency in the country or by filing the relevant documents within the applicable term with the Central Bank. Registration of foreign investment guarantees the foreign investor access to the foreign exchange market to purchase convertible currency to remit dividends and repatriate the investment. The failure to report or register could result in the imposition of fines by pertinent agencies and could imply that the investor would have to rely on the free market for access to convertible currency. The registration of foreign investment must be annually updated with the Central Bank.

Colombia has exchange controls, but these are relatively benign.

All foreign currency for the operations listed below must be acquired or handled through the 'exchange intermediaries' (ie, Colombian banks, some financial institutions and exchange houses) or by using overseas registered foreign currency accounts known as 'compensation' accounts:

- import and export of goods;
- foreign loans and earnings related thereto;
- foreign investment in Colombia and related earnings;
- Colombian investment abroad and related earnings;
- financial investments in securities issued or assets located abroad and earnings related to them, except when investment is made with currency originating from 'free market' operations (ie, operations that are not required to be made through the exchange market);
- guarantees in foreign currency; and
- derivatives.

All other foreign currency operations may be made through the exchange market or the free market. In general, Colombian regulations do not allow for the set-off of the payment obligations resulting from these transactions.

Update and trends

The Financial Regulation Agency (URF) has published draft regulations that will provide regulation for private equity funds independent from other close-end or open-end portfolio investments.

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Unless the law specifically permits otherwise, the general rule is that payments between Colombian companies or individuals must be made in Colombian pesos, or through compensation accounts.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Club and group deals are not uncommon in Colombia. Apart from the usual governance issues (business plans and annual budgets, special voting thresholds, anti-dilution protection, board composition and other minority protections), the issue that is probably given the most consideration is liquidity and the priority in the event of a disposal. While private equity firms are usually willing to have the same priority upon exit with other private equity firms, they will usually want to dispose of their entire holdings before the strategic partner is entitled to exit.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

The factors that usually provide some uncertainty to closing for private equity deals in Colombia are usually antitrust clearance, public tender offers and third-party consents. While private equity buyers will also sometimes seek to subject completion of the transaction to the availability of financing, the instances in which this is actually accepted by a seller are very few.

Penalty clauses are sometimes used to discourage the parties from failing to use their reasonable efforts towards satisfying conditions precedent, but will apply only when the relevant party has clearly breached a pre-closing covenant (such as applying for antitrust clearance or launching a public tender offer). Termination payments (ie, giving the parties the option to walk away from a deal if they so choose, by paying a fee to the other party) are rare. Clauses giving a prospective buyer the right to recover expenses incurred, in the event a deal fails owing to third-party interference, have been used in transactions requiring public tender offers.

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Croatia

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Predominantly, Croatian private equity (PE) transactions are restructuring transactions. In past couple of years there have been many transactions coming out of pre-bankruptcy proceedings with PE funds taking majority stakes and recapitalising the companies. This is also connected with the government's private-public partnership investor scheme, by which PE funds initially gathered 1 billion kuna of private investors' assets and the government invested another 1 billion kuna as a pari passu investor.

We have still not seen a fully grown risk capital market, meaning that there is still a lack of seed and growth capital and venture capital in general. At the national level we have seen some initiatives for a government/World Bank venture capital fund, but this has not yet come into effect. Internationally we have seen some start-up transactions, both as expansion capital deals and buyout transactions.

As to exits, the majority of exits have been sales to a strategic partner and rarely management buyouts. There were no IPO exits, but with some of the larger PE acquisitions we see some potential for doing so.

A typical Croatian PE transaction would be acquiring the shares through a special purpose vehicle (SPV), which is funded by equity or a combination of debt and equity. SPVs are typically a domestic limited liability company (LLC). Such an acquisition would be followed by share purchase agreements and shareholders' agreements with the rights of first refusal, and tag-along and drag-along rights and buy-in and buyout options.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

In Croatia, PE transactions primarily involve the joint stock company (JSC) and limited liability company (LLC). With JSCs the law applies stricter corporate governance rules than on LLCs. This is even more the case if the JSC is listed on the Zagreb Stock Exchange, whereby the Corporate Governance Code applies.

Taking the above into account we tend to see PE funds investing more into LLC structures, although in some restructuring investments we have seen companies remaining public for exit reasons, where the funds speculate on the possibility of IPO or SPO arrangements.

To conclude, going-private implies advantages such as simplification in reporting, less strict rules of nomination of the board of directors, etc.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

In general, under the Croatian Corporation Act members of the management board have the responsibility act in the best interest of the company.

Under the Croatian Capital Markets Act management must abide by the rules on market manipulation and insider trading and regular reporting to the public

In case of a takeover bid, the Croatian Takeover Act provides for the management to issue a statement containing its opinion with respect to the offer, the price, the strategic plan of the offeror and its statement on whether it will accept the offer. It is also required to disclose any of its agreements with the offeror, if they exist.

Under the Takeover Act, the management board is prohibited from taking any action in preventing the shareholders from accepting the offer. However, finding a competing offer is a management action that is explicitly allowed.

We have not seen the application of special committees in Croatia. However, from the general obligations of management arising out of the Stock Corporation Act, conflicts of interest rules are applicable and must be obeyed.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Under the Capital Markets Act, listed companies have the ongoing responsibility to report on price-sensitive information to the public. In this sense, initiation or talks about a going-private transaction might fall within the scope of price-sensitive information. The reporting might be postponed if such reporting could hurt the legitimate interests of the issuer. In this case the information must remain confidential. Otherwise, the information must be promptly published.

If a transaction involves a public offer in accordance with the Takeover Act, the offeror must comply with an extensive obligatory form of the offer, which must be approved by the Croatian Financial Services Supervisory Agency (the Regulator).

In the case of a merger, under the Corporation Act the management is under the obligation to provide a detailed report on the consequences of the merger, the merger agreement, etc. Such a report shall be inspected by the auditor. At least 30 days before the general meeting takes place the shareholder has the right to inspect the whole of the merger documentation, which must be placed in the company for free inspection.

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5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Timing considerations depend on the type of transaction, type of company and whether the company is listed. In every transaction, one should consider merger control notifications and approvals and regulatory consents in regulated industries. Depending on their complexity these can take some months.

In the merger transactions the relevant documentation prepared by the management and the auditor is issued 30 days prior to the shareholders' resolution on the merger. In the six months following the merger creditors can make a claim for issuance of security towards their claims.

With a takeover offer the offeror must request the Regulator to approve the offer and the documentation following the offer. The request should be filed within the 30-day period from when the obligation for takeover was created. The Regulator must decide on the request within 14 days following the filing of the full request. After the offeror has published the offer it can be accepted within the following 28 days. If the offer is amended the period will be prolonged for an additional seven days. In the event of competing offers both offers are only valid until the end of 60 days from when the first offer was published.

Under the Takeover Act, in the three months following the successful takeover, both offeror and the minority shareholder can mandatorily purchase or sell the shares (if the offer is successful and the free float is 5 per cent or less).

Under the Capital Markets Act, the delisting process shall take at least 38 days from when the agenda for the general meeting has been pronounced until the general meeting can vote on the decision. Subsequent to the decision, the shareholder can in the following three months sell its shares to the company.

Under the Corporation Act, the squeeze-out process will again take at least 38 days from when the agenda for the general meting has been pronounced until the general meeting can vote on the decision. The decision is made by a 95 per cent of the share capital vote and cannot be blocked by the minority shareholders. In the case of a dispute on the price offered for the shares, the court procedure can be lengthy.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

In accordance with the Capital Markets Act, taking a Croatian company private is possible if a decision to do so is rendered by the votes of shareholders representing at least 75 per cent of the capital, unless a higher majority for rendering such decision is prescribed. Such a decision is valid only if it includes an irrevocable statement of the company by which it commits to buy out the shares from all the shareholders who vote against such a decision at an equitable price. If a majority shareholder reaches a threshold of 95 per cent of the share capital having voting rights and 95 per cent of all voting rights, it may go ahead with a squeeze-out of the remaining minority shareholders at an equitable price.

To address the risks associated with shareholder dissent, the acquirer may seek the pre-approval by the target's board of directors for its recommendation to its shareholders and further secure conditional or unconditional acceptances from major shareholders of the target company. Also, appropriate preparations with respect to due diligence of the target company and preparations with respect to financing and other key conditions are conducted to mitigate the risk of revaluing or declining the offer.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

So far there have not been any significant differences between provisions of share purchase agreements in PE transactions and those in traditional M&A transactions in the Croatian market. As in other transactions, possible differences may arise owing to differences in the business of target companies, the previous negotiation process, the transaction price and whether a transaction is a buyout or a sell-out.

Provisions featured in share purchase agreements are usually those covering representations and warranties, calculation and payment of the purchase price, closing conditions, post-completion price adjustment, indemnities, confidentiality and non-disclosure, arbitration for dispute resolution, etc. The scope of warranties and indemnities as well as price adjustment possibilities are typically more extensive if PE is on the buy side, especially for majority deals.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

Bearing in mind that target companies of PE transactions in Croatia are often mid-market companies managed by the founders or members of the company themselves, management participation in the transaction is thus quite common. Its retention upon closing the share purchase agreement depends on whether a majority or minority stake is the object of the transaction. If, however, the selling shareholders are not part of the management, terms of further employment of the management and possible incentives are important parts of the pre-closing negotiations. Possible arrangements are still dealt with on a case-by-case basis but rarely include acquiring shares.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Gains that the shareholder of the target earns from the sale of its shares is subject to general corporate income tax set at 12 per cent for revenues below 3 million kuna and 18 per cent if revenues are equal or higher than 3 million kuna.

If the shareholder of the target company is an individual investor, then the gain derived from the sale of his or her shares will be subject to the capital gains tax of 12 per cent, provided that the acquisition and the sale took place within a three-year period. If the period is more than three years the individual investor is tax-exempt.

Generally, all types of salaries and benefits paid to an employee should be considered as employment income taxed with progressive tax rates. Salary costs are also subject to social security contributions for the employer, which is a deductible cost for the employer.

Management incentive programmes would usually entail acquisition of shares in the company, which allows the company to share dividend at the lower income tax rate than the general income tax rate or participation in the joint sale of the company's equity.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

As in any other M&A transaction, any type of debt structure is used for financing PE transactions. Commercial financing from banks is the most common mechanism. Possible securities for the financing provided may include real estate mortgages, pledges over the PE investor's assets, etc.

A JSC as a target company, according to article 234 of the Corporation Act, is prohibited from providing cash loans, securities or guarantees with the purpose of financing the acquisition of its own shares. When acquiring shares of a LLC such limitations can be avoided

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as there is no specific provision on that matter regarding acquisition of the shares of LLCs.

It should be noted that there have been some attempts at mezzanine financing as well.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Croatian law does not provide for specific provisions regarding going-private transaction purchase agreements. However, if the Takeover Act is applied to the transaction, a bidder must have ensured that it can fulfil any cash consideration in full regarding the said transaction. Hence, confirmation of a third-party entity granting the necessary funds must be available.

In general, regular financing documentation for a PE buyout consists of a loan agreement and the security documentation. Security documentation usually involves share pledges and other encumbrances, which of course depend on the nature and complexity of a particular PE transaction.

A squeeze-out procedure is considered as a post-closing step, therefore the purchase agreement shall include all aspects regarding the squeeze-out procedure.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Fraudulent conveyance as a specific type of fraud is not recognised under Croatian law. Therefore, if the requirements for capital preservation under the applicable Croatian law are fulfilled there shall be no specific fraudulent conveyance issues raised in PE transactions.

Croatian insolvency law prescribes that the insolvency administrator can, under certain conditions, challenge transactions entered into by the company prior to the opening of the insolvency proceedings.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

In situations when PE firms make minority or majority investments and the original shareholders retain control over the day-to-day management, shareholders' arrangements include transfer restrictions, board representation, veto rights and option rights. Of course, shareholders' agreements can also include exit mechanisms such as tag-along and drag-along rights, right of first offer, right of first refusal or the initiation of an IPO.

Statutory protection for minority shareholders differs whether the PE transaction involves a JSC or a LLC. The Corporation Act provides protection for minority shareholders' rights, stating that minority shareholders have rights to call a shareholders' meeting, information rights and minimum voting requirements for major measures (changes of purpose, corporate restructurings, changes to articles of association, dealings involving substantially all of the business or assets and squeeze-out transactions). Some of these protections are mandatory, while others can be amended without restriction.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Given that a public company is a company whose ownership is dispersed among the general public in stock shares that are freely traded on a stock exchange or in over-the-counter markets, the Takeover Act does not distinguish between public and private companies.

The Takeover Act captures direct and indirect controlling interests. Direct controlling interest is a situation where the bidder directly holds more than 25 per cent in a public company. On the other hand, indirect controlling interest or 'acting in concert' is a situation where a bidder cooperates with another natural or legal person on the basis of an agreement, either express or tacit, either oral or written, aimed at acquiring voting shares, concerted exercising of voting rights or preventing other persons from carrying out the takeover bid.

In this case the bidders are obliged to announce a takeover bid, where they have, directly or indirectly, independently or acting in concert, acquired voting shares of the offeree company, which, together with the shares they already possess, exceed a threshold of 25 per cent of voting shares of the target company. The bidders are obliged, within 30 days following the date the obligation to announce a takeover bid took place, to submit to the Regulator the application for approval of the announcement of a takeover bid. The bidders must announce a takeover bid within seven days following the date of receipt of the Regulator's decision.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

As already mentioned, the majority of exits have been sales to a strategic partner and rarely management buyouts. So far, there have been no IPO exits in Croatia.

In general, PE investors are reluctant regarding the assumption of liability for the target company after the exit, hence they try to minimise their liability by shortening the representations and warranties, introducing low caps. In addition, the management of the company can also participate in the same warranty and indemnity package granted by the selling PE investor.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Although IPO exits have yet to happen in the Croatian PE industry, when occurring otherwise, practice has shown that an IPO often terminates pre-IPO governance rights and other shareholders' rights, as well as board appointments and veto rights. The common lock-up period in which disposal of retained interests is prohibited varies from six to 12 months; however, this restriction is subject to negotiation and therefore may be significantly shortened or extended.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

As investments so far have been carried out based on the highest possible risk allocation, PE firms in Croatia have invested mostly in mid-market companies in a wide range of industries. Some recent target industries include communications, construction, textiles and food.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Generally, there are no restrictions on foreign investment.

The acquisition of a qualified or a controlling interest is subject to advance notification or approval in regulated industries such as communications, banking, insurance or leasing, which applies for both

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domestic and foreign transactions. As for acquisition of real estate ownership by non-EEA nationals, this is possible under the presumption of reciprocity and with Ministry of Justice approval. However, there are further limitations regarding certain types of real estate (eg, maritime goods, farmland, woodland, etc).

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Croatian law does not prevent or restrict the participation of two or more PE firms in a club or a group deal, although such deals may have to be considered in the context of antitrust legislation. Furthermore, according to the Takeover Act, all participants in such deals are deemed to act in concert. Also, if the bidder, together with parties acting in concert with it, acquires shares that together represent more than 25 per cent of the target then it will be required to make a mandatory offer for the target.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Closing in PE transactions depends on the value of the transaction, so in smaller deals closing occurs simultaneously with signing of the agreement. On the other hand, mid-market and larger deals leave a time lapse between signing and closing. In this case closing is often conditional on the fulfilment of specific prerequisites, mostly of a procedural nature.

The seller and the PE buyer can negotiate their rights and obligations regarding the closing, so they can agree in detail to closing conditions, termination rights, termination fees, etc. The parties often condition closing upon no material adverse changes in the business and operations of the target company between signing and closing.

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

As to different types of private equity transactions, from a legal standpoint the acquisition of stock remained the most important type of transaction in 2017. In particular, the leveraged buyout (LBO) is still the most important type of private equity transaction in Germany. By such LBO a majority or, increasingly, even a minority interest of the target company is acquired by the private equity investor, whereas the acquisition is funded only fractionally with equity but is instead leveraged. After the acquisition, the leverage shall be defrayed by the free cash flow of the target company or even by debt-financed distributions. Regarding the structure commonly used for such transactions, the respective acquisition of stock is conducted by a special purpose vehicle (SPV), typically organised as a German limited liability company (GmbH), whereas the SPV is directly or indirectly owned by the private equity fund. In order to ensure that the target company managers and the investors have a parallel interest in the target company, the target company managers are often granted equity participations in their target company (management participation programme). In addition, the managers' service agreements or a shareholder agreement usually provide for certain exit scenarios such as drag-along rights, tag-along rights, lock-up and good leaver/bad leaver provisions. Besides the LBO, the number of venture capital investments remained stable in 2017.

Apart from these, a private equity investor might technically also use profit-participation loans to invest in target companies. In doing so, the management of the target remains, at least legally, unaffected by the private equity investor. Unless explicitly otherwise agreed between the parties, the private equity investor shall, in this scenario, not have any legal influence on the management of the target, not even regarding structural decisions in the target company.

A private equity investor may also found a silent partnership according to sections 230ff of the German Commercial Code with the target company. Within such partnerships, the silent partner participates in the profit and the loss of the target company without being obliged to disclose its identity and investment in the target. Depending on the legal form of the target it might, however, be necessary to register the silent partnership with the respective commercial register and thus to at least disclose the participation of a third party in the target in general.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The implications of German corporate governance rules for private equity transactions are diverse.

First, under German law, corporate governance rules set out in the Corporate Governance Code (DCGK), last amended in February 2017, in connection with section 161 of the Stock Corporation Act (AktG) generally only affect listed companies directly. Therefore, only target companies listed on the stock exchange and thus essentially organised as a stock corporation (AG) or a limited partnership of shares (KGaA) have to comply with the corporate governance rules. As a consequence, any private equity investor targeting a listed company needs to comply with German corporate governance rules set out in the DCGK once having acquired the shares of the company.

Second, in the event that a non-listed company is the target of a private equity transaction, German corporate governance rules may also have an indirect influence on the private equity transaction. This is obvious for those corporate governance rules that are part of German law, for example, of the AktG or the German law regarding limited liability companies. Furthermore, as financing banks or even private equity investors might be listed and organised as a stock corporation or as a limited partnership of shares, they might have to comply with the corporate governance rules set out in the DCGK independently, which might easily have an influence on the structure of such private equity transaction.

If the private equity investor intends to conduct its exit via an IPO, strict compliance with applicable law and, in addition to that, with German corporate governance rules set out in the DCGK, is, of course, crucial.

There are in fact several advantages of going private in an LBO or similar transaction.

First, investors gain large-scale flexibility as to the company form. In particular, there is no need to continue to operate the target company as an AG. Instead, the target company can be converted into a GmbH or a limited partnership (KG). By changing the company form, not only can the maintenance and the administration of the portfolio company be eased, but closer control over the management of the portfolio company for the investor can also be achieved.

Second, once no longer listed, the portfolio company is not obliged to continue to comply with specific legal stock exchange requirements, which eases the maintenance and administration expenditures for the investor and, collaterally, reduces the costs for the portfolio company.

If the target company remains or becomes public following a private equity transaction, the company will have to bear additional costs in order to comply with German or different stock exchange requirements (or both). Besides, as a listed company, the portfolio company still needs to adhere to additional disclosure requirements owing to both German stock exchange law and German corporate governance rules. Among other information, a listed portfolio company would have to disclose its directors' salaries and, as the case may be, any directors' transactions in shares of the portfolio company.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

The specific issues facing boards of directors basically depend on the role of the public company within the transaction.

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If the public company itself is the seller of the target, the management of the public company will, because of its binding legal competencies, be the competent body to represent the seller during the transaction process. Because of this the management will, within the course of such legal representation of the seller, essentially become aware of sensitive information (as to, for example, the timing of the transaction). Because of very strict and specific legal stock exchange regulations, the management of the public company therefore needs to be very careful regarding the disclosure of such sensitive information to both the shareholders of the public company and the public. In particular, the management of the public company must not enable anyone to undertake insider trading. In the event that the management is entitled to an additional compensation upon the closing of the transaction, this compensation itself needs to comply with specific legal requirements. In particular, this compensation must be approved by the competent body within the company (usually the supervisory board or a special committee thereof) and the compensation must be appropriate. As to the legal competencies of the management in general, at least for the closing of the transaction, the management of the seller needs the approval of the supervisory board as well. In very rare, exceptional cases, a respective resolution of the shareholders of the public company is deemed mandatory by German case law. Some companies may also stipulate additional procedural safeguards or assign such decisions to a committee of the supervisory board; however, as far as stock companies are concerned the AktG is mandatory and stipulates certain minimum requirements as to the consent required for such transaction.

If the public company itself is the target of the transaction, its management has to accept a rather different personal role. As far as it is involved in the negotiations of the transaction between seller and potential buyer, the management of the public target company will have to decide what information could or should be disclosed without affecting or even violating either the company's or shareholders' interests (or both). To avoid a personal liability, it is advisable for the management of the public target company to coordinate its steps very closely with the competent supervisory board and to consistently obtain the relevant approving resolutions. In general, any advantage offered or to be offered to the (senior) management or the supervisory board of the target company needs to be disclosed. In terms of a potential conflict of interest, there is no specific legal regulation regarding how to resolve such conflict or potential conflict. However, it is essential for the management to disclose any kind of such conflict of interest.

In the event of a public takeover transaction, the management of the target company will have to explicitly comment on the takeover offer. As to the legal requirements of such comment, there are various specific issues that need to be addressed and fulfilled by the management regarding the takeover offer. Generally, under German law, the management of the target company is not allowed to take active defensive measures against the takeover.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

There have been heightened disclosure issues for private equity investors since 2008; since then, not only listed companies but also companies organised as an AG are subject to disclosure regulations under German law.

Before 2008, investors in listed companies in particular were (and still are) bound by various legal disclosure requirements that generally do not affect the usual private equity investor to the extent that an investment in a listed target company is not intended.

The Securities Trading Act (WpHG) and the AktG both set up different thresholds for equity holdings in listed companies and companies organised as an AG that, when reached, exceeded or fallen below, trigger different disclosure requirements for an investor. Under the WpHG, whoever reaches, exceeds or falls below 3, 5, 10, 15, 20, 25, 30, 50 and 75 per cent of the voting rights in a listed company is obliged to notify both the company as well as the competent financial supervisory authority, the Federal Financial Supervisory Authority. As a consequence thereof the company is obliged to publish the relevant notification. Comparable notification obligations are valid with respect to financial instruments that grant a right to acquire shares in a listed company. In addition to this, several regulations also address persons who 'act in concert' in this regard. The implementation of the EU Amendment Directive to the Transparency Directive into German national law required in particular amendments to the WpHG. Therefore, the WpHG was amended on 26 November 2015. While the disclosure thresholds have remained unaltered, the new regulations provide adjustments to the time of the notification, the attribution of voting rights as well as the notification obligations for financial and other instruments. Concerning non-listed stock corporations, the AktG sets out that any shareholder reaching a threshold of more than 25 per cent, or more than 50 per cent in the capital of a non-listed stock corporation, or whenever a shareholder falls below such thresholds, such shareholder is obliged to promptly notify the stock corporation. In the event that the shareholder fails to fulfil its aforementioned disclosing obligations, it will lose its entire rights rooted in its shares. Following this notification the stock corporation has to publish such changes. In order to make the shareholding structure of non-listed stock corporations more transparent, the German legislator limited the admissibility of bearer shares for non-listed companies by amending the AktG, which came into force on 31 December 2015.

Apart from these pre-existing rules, additional regulations were implemented in 2008 in Germany under the Federal Act to Limit Risks Related to Financial Investments. The main objective of the act is to restrict undesirable activities of financial investors by enhancing transparency for their financial transactions without generally eliminating financial investors from such investments. Based on this act, a potential acquirer shall now be obliged to disclose more information regarding his or her specific intentions with the target; his or her reasons for the respective transaction; and, in particular, the sources of the funds used. The examples used for the act were similar regulations in the US and France, in particular section 13d of the US Securities Exchange Act. Besides many other reflections in different fields of the law, the act in particular states that a purchaser of an essential participation – whereas such participation shall be deemed essential once reaching or exceeding a threshold of 10 per cent of the voting rights – is now required to fully disclose the aforementioned information as to the purpose of and the funds for the transaction. However, exceptions from such disclosure requirements are possible.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Once a private equity investor intends to go private after the investment (regarding the advantages, see question 2), the investor needs to obtain, as a matter of course, an equity position in the target company that enables him or her to obtain the required board resolutions (see question 6 regarding the recent changes in German case law) in the future. As the acquisition of such equity position in a listed company is subject to strict legal regulations under German law, the time frame for such transaction is basically determined by those legal regulations governing the acquisition of such majority interest in a listed company.

According to German case law, the time frame for a going-private transaction is basically determined by the regulations set out in the Securities Acquisition and Takeover Act (WpÜG), since the required majority can only be obtained in accordance with the following time frame set out in the aforementioned act:

- a decision whereby the investor intends to place a public takeover offer for the shares of the target company must be notified to the boards of any stock exchange where the shares of the target company or derivatives thereof are listed within due course. Such notification must also take place with the Federal Financial Supervisory Authority and finally be published in the relevant media;
- within four weeks of the publication of the decision, the investor must then submit a comprehensive draft offer to the Federal Financial Supervisory Authority;
- this offer must then be published immediately after the Federal Financial Supervisory Authority has approved the publication or after 10 working days have expired without objections to the publication by the federal office;
- the acceptance period shall be at least four weeks but should, however, not exceed 10 weeks after the publication by the Federal Financial Supervisory Authority; and

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- upon obtaining a majority of at least 95 per cent of the share capital of the target company through such bidding proceeding, the investor can initiate a squeeze-out proceeding according to section 39a of the WpÜG within three months, starting with the expiry date of the acceptance period. Such squeeze-out in accordance with the WpÜG not only lowers the formal requirements but also simplifies the procedure to determine the cash compensation for the squeezed-out minority.

The overriding objective for bidders under the vast majority of German takeovers is for the bidder to acquire 100 per cent control of the target. In a successful takeover offer, however, there will always be a few target shareholders who, intentionally or otherwise, fail to accept the offer. German law provides for three different procedures allowing for the squeeze-out of the minority shareholders. If an investor already holds a majority of at least 95 per cent of the share capital of the target company he or she can initiate a squeeze-out proceeding in accordance with sections 327a et seq of the AktG with a respective shareholders' resolution according to a different schedule, as follows:

- the minimum notification period for such shareholders' meeting is 30 days. However, from a practical point of view, since the drafting of the required documents, and, in particular, the report regarding the adequate cash compensation for the minority shareholders usually take several months, the legal minimum notification period is usually not sufficient;
- once the aforementioned squeeze-out resolution has been conducted, it can only be challenged by the squeezed-out minority shareholders within one month of the resolution. In the event of a lack of such formal challenge, the squeeze-out will be registered with the expiry of this period; and
- since any of the rather frequent potential disputes arising in connection with the cash compensation for the squeezed-out minority shareholder can only be taken to special tribunals such disputes will, by law, therefore not delay the legally required registration and effectiveness of the squeeze-out.

Owing to an amendment to the Law regulating the Transformation of Companies in 2011 a new alternative to squeeze-out minority shareholders has been implemented. Since then, majority shareholders in the legal form of a stock corporation can initiate a squeeze-out proceeding if they control at least 90 per cent of the share capital of the target company. The squeeze-out works in connection with an upstream merger of the target into the controlling shareholder. With respect to the necessary timeline there is no substantial difference to the other alternatives.

In private equity transactions, which are by comparison not affected by the regulations regarding listed companies, timing considerations are basically determined by financing and antitrust issues. In particular, in those cases in which the seller is not willing to accept a clause according to which the closing of the transaction shall be subject to proper financing of the purchaser, the signing is typically delayed until a sufficient financing commitment for the purchaser is finally granted. As to German competition law, the closing of a transaction shall not be carried out prior to the expiry of a one-month period after a required notification with the Federal Cartel Office has been made. Within this month, the Federal Cartel Office can decide whether to initiate further examinations of the transaction, which shall be completed at the latest within four months after the notification.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

A (minority) shareholder is still in a position to effectively dissent or object to a going-private transaction in case such delisting shall be accomplished through a cold delisting. Under German law, the typical measures used for such cold delisting, for example a change of the corporate form, a merger with a non-listed legal entity or a contribution of the company or its business to a non-listed company, require the consent of at least 75 per cent of the shareholders. As a squeeze-out of an objecting minority shareholder requires a majority of at least 90 or 95 per cent of the share capital (for details, see question 5), any minority shareholder exceeding such threshold can practically prevent such measures effectively.

In the case of a formal (hot) delisting, minority shareholders can no longer effectively dissent or object to a delisting. In former times such shareholders were in the position to dissent or at least significantly delay a formal delisting as well as, according to previous German case law, a formal delisting also requiring a shareholders' resolution and a cash compensation for objecting minority shareholders. With a decision dated 12 November 2013, the Federal Court of Justice explicitly gave up its previous legal practice and stated that the company's management and supervisory board may now decide together upon a formal delisting of the company, whereas an additional shareholders' resolution shall no longer be deemed mandatory. The Federal Court of Justice further denied cash compensations for objecting minority shareholders in case of such formal delisting. This legal situation has changed significantly by a law of 20 November 2015. Pursuant to section 39, paragraph 2 of the Stock Exchange Act, the revocation of the listing upon request of the issuer now requires a simultaneous acquisition offer to all other shareholders. This offer cannot be subject to any condition and the consideration has to be a monetary payment principally based on the stock exchange price. However, an additional shareholders' resolution is not required and therefore, minority shareholders can only decide to either sell their shares or remain shareholders in the delisted company. Furthermore, a formal delisting is permitted if the shares are traded within the regulated market in either a domestic or a foreign stock exchange (in such case there is no complete delisting).

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Generally, the provisions of purchase agreements in private equity transactions do not differ fundamentally from the provisions used and discussed in other purchase agreements. In other words, representations and warranties as well as mechanisms of purchase price adjustments are also usually the most important issues of private equity purchase agreements. However, if the private equity investor acts as a buyer, in most cases the financing structure of his or her leveraged transaction will be absolutely crucial for the private equity investor. Therefore, material adverse change (MAC) clauses consigning the content of the MAC clauses accepted by the private equity investor in his or her financing agreements are sometimes seen in the context of private equity transactions. However, owing to the fact that strategic buyers are very competitive with their bids, in particular owing to the premiums offered, private equity investors are not only required to offer higher prices but are increasingly also requested to provide transaction certainty (eg, by agreeing to an equity commitment letter, or an all-equity financing or reverse break fees, or both). However, all-equity financed transactions are typically structured in such a manner that a future partial debt refinancing is feasible. If the private equity investor acts as the seller of a portfolio company the amount of representations and warranties is often intended to be reduced, for example, by a partial substitution for representations and warranties granted by the management of the portfolio company. Against the background of the very seller friendly environment, private equity investors as sellers very often request a 'hell or high water obligation' from the buyer (ie, the buyer has to agree to use its best efforts and to take promptly any and all steps necessary to avoid or eliminate each and every impediment under any antitrust, competition or trade regulation law that may be asserted by any governmental authority with respect to the transaction so as to enable the transaction closing to occur expeditiously).

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

The participation of the management in a going-private transaction can be shaped in different ways. First, equity participations may be used, whereas the management is either offered an interest in the

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target company itself or, more often, in a respective trust company holding the shares of the target company. Second, it is also common to grant a management bonus, often offered in exchange for shorter termination periods of the management contracts. In cases where a shareholder position of the management is to be avoided, phantom stocks are offered to the management. Finally, stock options may also be used for management participation. From a practical point of view, however, in most cases the aforementioned instruments are usually combined to individual management participation schemes and designed to avoid negative tax implications for the management.

As to the principal executive compensation issues, the compensation of directors of an AG is required to be appropriate. From a legal point of view, the compensation must be established with a view to the best interests of the company only, not of its shareholders or directors. The violation of such principle might even qualify as a criminal offence by the members of the supervisory and the management board. In addition, the provisions of the WpÜG prohibit the offering of unjustified advantages, regardless if granted in cash or in any other kind, to members of the management or supervisory board of the target.

As to the legal obstacles of such management participation under German law, it is, however, advisable to disclose it as soon as possible although there are no strict legal timing considerations.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The main topics in private equity transactions are the reduction of the tax exposure of the target and holding company by maximising the tax deductibility of interest expenses triggered by the loans that fund the purchase price for acquiring the target and tax-efficient strategies for the repatriation of the target's profits and a tax-efficient exit scenario. Against the background of the very strict German loss limitation rules, existing tax losses or tax loss carry-forwards should be used by the seller of shares prior to transferring the beneficial ownership of the shares, if possible. From a buyer's perspective, such tax losses or tax loss carry-forwards are not of any commercial value in most cases unless the assets of the target contain hidden reserves that could be used to preserve losses or loss carry-forwards. Furthermore, the real estate transfer tax consequences need to be borne in mind, as the indirect transfer of real estate by way of the acquisition of at least 95 per cent of the shares or interest (a commercial participation is sufficient) held directly or indirectly in the real estate holding entity could trigger real estate transfer tax of 3.5 to 6.5 per cent (depending on the federal state where the real estate is located). Finally, the seller needs to thoroughly check the historic share transfers to avoid any negative tax consequences because of reorganisation measures in the past.

Regarding the tax status of a target, it is typical to achieve a tax consolidation through a fiscal unity with the holding company in Germany if the target is a corporate entity. A fiscal unity allows the pooling of the profits of the target and the interest expenses of the acquiring holding company. In certain situations a debt pushdown strategy or a merger scenario may also be an instrument to minimise tax exposure in Germany.

The tax deductibility of interest expenses on debt financing exceeding the interest earned (net interest expenses) is – simplified – generally limited to 30 per cent of the tax EBITDA of the interest-paying entity (Interest Barrier Rule), except where the net interest expenses are less than €3 million per year; the interest-paying entity does not form part of a fully consolidated group (Non-Group Test); or in the case of the interest-paying entity forming part of a fully consolidated group, this interest-paying entity's equity ratio is, at most, 2 percentage points below the entire group's equity ratio (Group Test). It should be noted that with respect to the Non-Group Test and the Group Test additional requirements need to be met, if the interest is paid to an affiliated company or a third party (such as a bank), which can take recourse against such an affiliated company, unless the affiliated company receiving the interest payment or granting the collateral to the third party forms part of a fully consolidated group together with the interest-paying entity.

With regard to this Interest Barrier Rule, it is worth noting that any interest payment will be calculated irrespective of the nature of the interest (interest on a bank loan (taking into account any fees paid to the bank, shareholder loan, subordinated debt, etc)).

Any intra-group transaction including intra-group financing needs to pass the arm's-length test and needs to be documented thoroughly pursuant to the domestic legal requirements applicable for transfer pricing documentation.

With regard to the exit, a sale of the shares held by a company, such company not qualifying as a financial institution for tax purposes, in the target being a company, will also ensure a capital gains taxation pursuant to German domestic tax law within a range of approximately 0.8 to 1.7 per cent in Germany (subject to the applicable double taxation treaty, if any). The tax burden depends on whether the selling company is additionally subject to German trade tax because of a permanent establishment in Germany.

With regard to executive compensation there are no particular rules for a beneficial taxation, and generally any advantage because, for example, a reduced purchase price is taxed as salary at full income tax rates. Upon exercise of stock options below fair market value the difference between the exercise price and the market price is also an advantage, fully taxable as salary. If the acquired shares are sold the privileging rules of the capital gains taxation apply unless the executives are not considered beneficial owners of the shares (eg, owing to good or bad leaver rules). In such cases a capital gain would also be classified as salary subject to wage taxes.

An acquisition of shares of a target company does not offer a step-up. The acquisition of the interest in a partnership will be classified as an asset deal for tax purposes that offers the opportunity for a step-up pursuant to general rules only if the target has the legal form of a partnership. This is because partnerships are tax-transparent.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Senior bank loans remain the most common form of financing. Large cap transactions may also utilise high yield bonds or (in the case of strategic buyers) more traditional senior notes or convertible notes (eg, the Bayer/Monsanto takeover). Mezzanine and second lien debt is hardly seen. Debt funds and other alternative capital providers are increasingly active, but typically more in the small and mid-cap market. Schuldscheine and other private placements are not used for acquisition purposes. Existing indebtedness of a target company impedes the financing of a private equity transaction, as it may reduce or even eliminate the ability of the target to provide guarantees or security for financing acquisition debt. Therefore, the (concurrent or subsequent) refinancing of the target debt is a key structuring consideration. Any German company in the form of an AG, a KGaA or a German-incorporated Societas Europaea (SE) is prohibited from providing financial assistance (ie, providing advances, loans, guarantees or security for the benefit of third parties in connection with the acquisition of its shares). As no whitewash procedure exists in Germany, a merger, a debt push-down, a domination or profit and loss pooling agreement (or both) or a change of legal form must be effected post-closing before upstream guarantees or security may be granted by the target group.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

As to debt and equity financing provisions, going-private transactions are rather different to any other private equity transaction. Generally, prior to announcing its intention to place a takeover offer the bidder must have ensured that he or she is capable of fulfilling all of the payment obligations under his or her offer ('certain funds'). Therefore, a confirmation of a third-party bank granting the necessary funds must

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be available. The bank issuing the financing confirmation must be licensed to do business in Germany (ie, domiciled in Germany or operating in Germany under a European passport). The bank will be liable towards the shareholders if the bidder fails to pay the consideration and the bank was aware, or failed to know because of gross negligence, that the funding was not certain.

A squeeze-out procedure is often envisaged as a post-closing step. Alternatively, the purchaser might choose to enter into a domination agreement with the target company to ensure his or her control. This will, however, require the target to pay guaranteed dividends to the minority shareholders, which may put additional strain on the group's cash flow and financing case.

An initial offer will often be backed by bridge loan documentation. Certain funds confirmations on the basis of commitment documents are rarely seen. Most sponsors will strive to enter into long-form documentation before closing. Bridge financing typically has a 30 to 90 day maturity.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Subject to the generally applicable hardening periods, there are no specific 'fraudulent conveyance' issues raised in private equity transactions, provided that the German legal requirements for capital preservation are fulfilled. According to German insolvency law, however, there are certain restrictions as to the refund of shareholder loans or equivalents that might limit the possibilities of refinancing the leverage of the transaction.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

If the investment is made by two or more private equity investors or the investor acquires less than 100 per cent in the target company, a shareholders' agreement typically contains regulations regarding veto rights, purchase options, pre-emptive rights as well as tag-along and drag-along rights according to the individual exit strategy of the investors. Also specific rights and obligations with regard to an intended IPO are often stipulated.

Owing to the fact that the overall deal flow is moderate with only few large-scale landmark transactions and as the majority of private equity transactions are mid- or even small-cap transactions, private equity firms are also increasingly open for investments in minority interests. In these cases, however, a decisive board representation at the target is usually requested, such as in the supervisory board of a stock corporation or in an equivalent board of a limited liability company. Besides comprehensive information rights (most likely including full access to accounting documents and people), consent rights, transfer of share restrictions for other shareholders and individual rights regarding purchase options as well as the exit scenario are often stipulated in the shareholders' agreements. Apart from that, German corporate law provides for statutory provisions in favour of minority shareholders, in particular certain information rights and rights of inspection that cannot be waived in total, even by the shareholder itself. Besides, fundamental actions concerning the statute or existence of the corporation in total require the consent of a qualified majority or even of all shareholders. The actual level and scope of such legal protection for minority shareholders depends, however, on the respective legal form of the company. In general and subject to the disposition of the parties, German law sets out a higher level of minority shareholder protection for a KG compared to a GmbH or an AG because of the legal principle that within limited partnerships the partners generally are deemed to have a closer relationship among each other whereas the relationship of shareholders of a limited liability company or a stock corporation is mainly characterised by the divestiture of capital and shareholder.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Unlike the acquisition of a controlling stake in a private entity, the acquisition of such a stake in a listed entity, a public takeover, is regulated under German law. In this case, the regulatory regime provided by the WpÜG, which was amended in the course of the implementation of the EU Takeover Directive in 2006 and is thus harmonised throughout the EU to some extent, must be observed by a private equity firm acquiring a controlling stake. Under the WpÜG, the obligation to submit a mandatory offer arises if a private equity firm acquires control over the target company, whereby 'control' shall mean the holding of at least 30 per cent of the voting rights in the target company. As to the Act to Limit Risks Related to Financial Investments the relevant thresholds for mandatory takeover offers must be calculated in line with the 'acting in concert' standards set out by the aforementioned act. According to section 35 of the WpÜG, any person who directly or indirectly attains control of a target company is required, without undue delay and at the latest within seven calendar days, to publish this fact stating the size of his or her proportion of the voting rights. Within four weeks of publication of the attainment of control of a target company, the bidder is required to transmit an offer document to the federal agency and to publish an offer (for the timing considerations in general see question 5). With respect to private companies, there are no statutory limitations on the ability to acquire control besides, of course, the relevant restrictions of German or EU antitrust laws as well as the relevant restrictions of the Foreign Trade and Payment Law (see question 18).

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

From a practical standpoint, the recent global financial situation is still the main economic limitation for many private equity firms to exit their portfolio companies. Throughout 2017, the IPO market was at a similar level as in 2016 and for most private equity firms the conducting of an IPO of a portfolio company still remains less attractive compared to the sale of a portfolio company. IPOs usually do not allow for a full, immediate exit by the private equity seller, as lock-up commitments may need to be given by existing shareholders. Even after the lapse of these commitments, a sale of a substantial amount of shares will negatively impact the share price and will raise questions about the prospects of the company.

Also, in the case of an IPO, several legal requirements need to be observed. In particular, the portfolio company must be organised either as an SE, an AG or as a KGaA prior to the IPO. Additionally, the legal requirements for a listing according to the Stock Exchange Act and the Stock Market Admission Rules have to be fulfilled, which typically results in comprehensive preparation and even restructuring measures for the portfolio company.

As to post-closing recourse for the benefit of a buyer, private equity investors are generally very reluctant regarding the assumption of liability for the target company after the exit, in particular as the day-to-day business of the target or even a period prior to their own investment is concerned. Therefore, they try to minimise their liability by shortening the representations and warranties, introducing low caps and substituting their own representations and warranties by such representations and warranties given by the management or a warranty and indemnity insurance, which bridges the gap between the offered and sought protection of buyers. In this context, the management can also participate in the same warranty and indemnity package granted by the selling private equity investor. The damage compensation in case of a breach of such management representations and warranties is usually limited to the amount of the participation of the respective managers in the company, and the private assets of the manager are usually not affected or only affected to a limited degree. To ensure that the management gives customary representations and warranties, appropriate

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Update and trends

On 9 June 2017, the ninth amendment to the Act against Restraints of Competition (the Amendment) came into effect. The Amendment provides inter alia major changes with regard to successor and parental liability. While under the current Act against Restraints of Competition companies fined for infringement of competition law could escape liability by certain types of restructuring, the Amendment closes this loophole and introduces two key changes in this regard:

- a cartel fine can also be imposed on the company that acquires the infringing company's business; and
- by adopting the EU's notion of 'undertaking', the Amendment will enable the parent and/or group parent company of a subsidiary involved in infringing conduct to be held jointly and severally liable for a fine issued to its subsidiary, provided that the companies constituted a single economic entity and the parent company exercised a controlling influence over that subsidiary at the time of the infringing conduct.

This new regime represents a fundamental change to German antitrust law that has, so far, based itself on the constitutional principle that only an entity engaged in illegal conduct can be held liable for an infringement.

Furthermore, Germany seems to have become a new core market for private equity in Europe. The development of the private equity market in Germany, Switzerland and Austria (GSA) stands out from the market in the rest of Europe. The total number of transactions in GSA rose from 265 in 2015 to 324 in 2016, an increase of 22.3 per cent. Correspondingly, the total deal value increased by as much as 51.7 per cent to €41.3 billion.

Trends observed in previous years were still visible in 2017, including longer holding periods, extended buy-and-build activities, the application of warranty and indemnity insurance policies and trading in secondaries.

agreements between the management and the private equity investor are often already concluded in the course of the acquisition of the target by the private equity investor.

If a portfolio company is sold to another private equity firm the management will typically reinvest in the target company. The representations and warranties of the seller will sometimes be substituted by those of the reinvesting management as far as the day-to-day business is concerned. Thus the situation for the seller is different as the buyer will rather accept such substitution as opposed to a strategic investor.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

According to the AktG, rights to appointments to the board or veto rights for specific shareholders are possible to some extent, although this is very unusual. Since tag-along and drag-along rights can only be established in a shareholders' agreement those shareholders investing in the company after the IPO are typically not bound by such agreements. As to registration rights, private equity investors frequently establish such rights in the course of the acquisition of the target company although it is still contested whether such contractual rights are in fact enforceable. Post-IPO transfer restrictions on pre-IPO shareholders remain common. Generally, the pre-IPO shareholders are in most cases only entitled to sell a small portion of their stocks in the course of the IPO or within a defined time frame after it. If, in accordance with a typical management participation model, the management participates directly as shareholder, it is usually bound by such lock-up restriction for a period of at least six to 12 months. Such lock-up periods for private equity investors seem to be increasingly shortened.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Although private equity transactions occur across almost all industry sectors there seems to be a certain preference to invest in software, internet and IT undertakings as well as automotive, media and pharmaceutical companies (including biotech and medicine). A further investment target in 2017 was the infrastructure industry and is most likely to remain so in 2018.

We do not see any industry-specific regulatory schemes that strongly tend to limit potential targets for private equity firms although German legal requirements may complicate transactions in some industry sectors (eg, the defence industry).

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

A third-party bank must confirm the availability of funds for any cash component of the offer. The third-party bank therefore must be as follows:

- a German bank or a German financial service provider;
- a non-German bank or financial service provider with its seat within the European Economic Area; or
- a non-German bank that maintains a branch in Germany with the approval of the competent federal office.

With respect to foreign investment restrictions, the Foreign Trade Act and Foreign Trade and Payments Regulation stipulate provisions that effectively enable the Federal Ministry for Economic Affairs and Energy (the Ministry) to block any acquisition of stakes in German businesses if the following is true:

- the purchaser is a non-EU person or 25 per cent or more of the voting rights in the purchaser are owned by a non-EU person;
- in the course of the transaction the purchaser directly or indirectly obtains 25 per cent or more of the target's voting rights; and
- the transaction threatens the public order or the safety of the German state.

In the ninth regulation amending the Foreign Trade and Payments Regulations dated July 2017, the Ministry introduced new, stricter rules regarding the examination of acquisitions of German companies and especially extended the list of companies whose acquisition is subject to a notification requirement as well as review periods and information obligations. The new provisions affect in particular acquisitions of and investments in companies operating critical infrastructure in energy, IT and telecommunications, transport, health, water, food, finance and insurance sectors and companies that contribute to such a critical infrastructure, in particular providers of industry-specific software, certain cloud computing providers and companies dealing with telematics infrastructure. However, they are also relevant for corporate acquisitions in other sectors owing to the extension of review periods and information obligations.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

If more than one private equity firm is participating in a group or club deal, the investors must team up to the extent that homogeneous action towards the portfolio company is guaranteed, while at the same time ensuring that the individual strategy of each private equity investor is still considered. Thus, various specific and explicit regulations between the investors are usually deemed necessary. As far as there is one predominant group member the minority rights of the other members need to be protected. While the predominant member will emphasise

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the need the group members will, at least to some extent, have to vote their shares in line to assure the factual capacity of acting for the investors. If club or group members are equally strong, deadlock scenarios need to be regulated.

Besides the internal organisation of the group or club members, some special considerations have to be obtained if a group of investors intend to take over a listed company, in particular since the relevant thresholds for mandatory takeover offers are also calculated in line with the 'acting in concert' standards. According to that, acting in concert is no longer limited to the coordination of an exercise of voting rights in the shareholders' meeting. Instead, cooperation apart from exercising voting rights may, in the future, result in an attribution of voting rights as far as the cooperation is aimed at a 'permanent and significant change of the issuer's entrepreneurial approach'. An exemption applies to 'one-off' voting agreements. Club and group deals offer interesting opportunities to structure the financing of the acquisition tax efficiently against the background of the German interest barrier rules that limit the tax deductibility of the interest expenses.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

In 2017, transaction certainty was a major issue in private equity transactions. As a consequence, private equity investors were still required to give up their (initial) requests for MAC and financing out clauses but were still required to accept hell or high water obligations, substantial reverse break fees or otherwise provide confidence that closing will take place.

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India

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity (PE) transactions in India broadly comprise early-stage investments, including seed capital, angel investments and venture capital, growth capital, including expansion capital, and late-stage investments, including private investments in public equity, buyouts and turnaround capital. Traditionally, early stage transactions in India fell under the umbrella of venture capital investments. However, this trend has changed in the past few years, with many traditional venture capital investments rivalling PE investments in terms of deal size and valuation.

Most PE investments in India occur in closely held unlisted companies. PE investments in listed companies are less frequent for a number of reasons, including the following:

- the lack of quality assets for PE investors to commit substantial funds;
- the inability of PE investors to complete 'going-private' deals on account of the inefficiencies of India's delisting regulations and the limited options available to complete minority squeeze-outs;
- the limited extent to which PE investors may seek enforcement of shareholder rights customarily sought in such transactions; and
- the inability of PE investors to obtain acquisition financing (except in limited circumstances).

India has historically been a market for minority investments by PE firms, including global buyout firms. This trend has changed, as most of the major buyout firms active in India are looking for control transactions. For efficiency of capital gains tax following exit from Indian investments, several PE transactions have traditionally been structured by using an offshore parent company with one or more Indian operating assets. The transaction documents in such structures are governed by foreign law and are subject to the jurisdiction of foreign courts. Foreign PE investors have been comfortable with such structures, as they reduce the enforcement risk considerably. In addition, they provide investors with exit flexibility, as they may opt to list their portfolio companies offshore or sell them to large foreign strategic players. In both cases, the portfolio companies have greater access to capital as a result. However, with more certainty around the enforceability of shareholders' rights, the transaction documents of a significant number of transactions are governed by Indian law.

Most PE investments are structured as primary or secondary investments, or a combination of both. PE investors typically invest in equity or preferred capital, or a combination of both. Indian exchange control regulations recognise only equity shares, compulsorily convertible shares, compulsorily convertible debentures and warrants exercisable for the aforesaid instruments as permitted capital instruments. All other instruments that are optionally or not convertible into equity or equity-like instruments are considered debt, and are governed by separate regulations.

Indian regulators have recently permitted certain registered start-ups to raise funds from foreign investors through convertible notes. Convertible notes are initially debt instruments that are repayable at the option of the holder or convertible into equity shares within a period of five years from their issuance. The regulations specify a minimum investment amount and also permit the transferability of such instruments in accordance with Indian exchange control regulations.

In addition, Indian exchange control regulators prohibit foreign investors from seeking guaranteed returns on equity instruments in exits. Consequently, PE investors are, at times, limiting their equity exposure in Indian companies by investing through a combination of equity or preferred capital and listed non-convertible debentures (NCDs). Investments through listed and unlisted NCDs are less regulated and may be secured by Indian assets in favour of an Indian resident trustee. PE investors are able to structure their investments in a manner that maximises capital protection by stipulating a minimum return on the NCDs, while also participating in the risks and rewards of the portfolio company as a shareholder.

An increasing trend is for foreign strategic players with surplus capital to invest in Indian assets. Several strategic players have established proprietary PE arms and have led notable transactions in the past year. Similarly, several government-sponsored foreign pension funds are following suit with sovereign funds, and increasing their exposure in India.

Other emerging trends include several large PE investors participating in consortium or club deals, and participating in the sale of Indian assets through an auction process. In both cases, the primary considerations are the lack of opportunities to invest in quality assets and the inflated valuations of certain assets. This has increased competition among PE investors and has also led to several mid-sized PE investors forming consortia to compete with larger PE investors on large transactions.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Indian corporate governance rules vary for different types of companies. The Companies Act 2013, of India (CA2013), which has been introduced in a phased manner since 12 September 2013, generally imposes stricter governance and disclosure norms on Indian companies than its predecessor, the Companies Act 1956 of India (to the extent that it has been replaced). However, private companies continue to be subject to relatively lesser scrutiny and are exempted from complying with several governance-related provisions of CA2013, unless such private companies have issued outstanding listed debt securities (in which case such private companies are treated as listed companies for the purposes of CA2013 and are subject to various additional corporate governance requirements that are otherwise not applicable to them). For example, at least one-third of the directors of a listed public company must be independent directors, and the boards of listed companies must comprise at least one woman director. Closely held public companies have stricter corporate governance norms than private companies, and public listed companies are subject to maximum scrutiny in terms of corporate governance and public disclosure. Public listed companies are subject to a number of corporate governance regulations specified by India's public markets regulator, the Securities and Exchange Board of

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India (SEBI), and the relevant stock exchanges, including under regulations pertaining to continuous listing, tender offers, insider trading and delisting.

From the perspective of a PE investor, corporate governance and disclosure rules are set out either in shareholders' agreements or the charter documents, or both, in investments in private companies or closely held public companies. While this affords greater flexibility in prescribing strict governance norms, PE investors often face difficulties in having such norms followed given the lack of accountability and awareness of Indian promoters. On the other hand, investments in public listed companies offer PE investors greater protection on account of the higher levels of compliance required of such companies and the obligation to make public disclosures to shareholders of every material action, omission or event.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Directors of Indian companies are required to disclose their interest or concern at the time of their appointment and at the first meeting of each financial year, and any change in interest or concern during a financial year, at the first meeting subsequent to such change. In addition, directors are not permitted to participate in meetings where a contract or arrangement in which such directors are interested is being discussed. In the context of PE transactions, directors who are nominees of selling shareholders, or are otherwise interested or concerned with selling shareholders, are prohibited from participating in meetings where such transactions are being discussed. This ensures transparent and fair decision-making, and is of particular relevance in PE transactions involving public listed companies where large numbers of public shareholders are affected by the terms of such transactions.

In addition to the above corporate governance requirements, capital issuances by companies under CA2013 require the approval of shareholders in most cases. In a preferential allotment of shares to a PE investor, shareholders have to approve of the transaction by way of a special resolution (ie, the number of votes cast in favour of the resolution is not less than three times the number of votes cast against the resolution). In a secondary investment in a public company, shares are freely transferable under law, and the board ordinarily does not have any right to prevent a transfer.

In PE transactions concerning public listed companies, applicable regulations relating to tender offers, insider trading and delisting prescribe additional obligations on directors, including specific approvals for tender offers and going-private transactions. In tender offers, no person representing the acquirer may become a director of the target company, unless certain conditions are met (such as 100 per cent of the consideration payable to public shareholders under the tender offer being deposited in an escrow account following expiry of the competitive offer period). Further, if the target company's board already comprises a director representing the acquirer, then such director is not allowed to vote on any matter relating to the tender offer.

From the perspective of Indian insider trading laws, PE firms often take a pragmatic view on the nomination of directors on boards of directors of Indian listed companies. A PE nominee director may have access to material 'unpublished price sensitive information' in his or her capacity as a director, which may taint, or otherwise restrict the ability of the PE investor to deal in securities until such information either comes into the public domain or no longer continues to be price sensitive.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

In the case of a public listed company, a 'going-private transaction' would, inter alia, require a mandatory exit option being given to the minority or public shareholders of the target company. The entire process of delisting requires, inter alia, approval of the board of directors and two-thirds of the public shareholders and making newspaper advertisements for providing a mandatory exit to the public shareholders, etc. In addition, conversion of a public company into a private company requires approval of the registrar of companies (and in a squeeze-out through a scheme of capital reduction, approval of the courts too). Therefore, the process of 'going private' under Indian law requires fair bit of disclosures to be made to both governmental authorities and the public.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The timeline for completion of PE transactions in India depends on a number of factors, including the nature of the transaction, the sector of investment, regulatory requirements, antitrust issues, deal size, due diligence issues, structuring and tax (both domestic and international) considerations.

PE transactions in private and closely held public companies in sectors that do not require regulatory approvals for making investments can be completed fairly expeditiously. Such transactions are ordinarily completed within four to six weeks of the term sheet being signed.

The timeline for completion of PE investments in regulated sectors (other than 'sensitive sectors', being those that require security clearance from the government) where transaction clearance is required from Indian regulators, including the Reserve Bank of India (RBI), the relevant administrative ministry, the Cabinet Committee of External Affairs, the Competition Commission of India and the Insurance Regulatory and Development Authority of India, is considerably longer and usually takes anywhere between eight and 20 weeks. The timeline for completion of PE investments in sensitive sectors usually takes between four and six months.

With a view to improving ease of doing business in India, the Indian government abolished the Foreign Investment Promotion Board (FIPB) in 2017. The FIPB was the erstwhile nodal agency for considering and approving foreign direct investment (FDI) proposals. The government now regulates FDI proposals in regulated sectors through competent authorities or ministries for specific sectors (administrative ministries) as per the procedure prescribed in the recently issued Standard Operating Procedure, while the Department of Industrial Policy and Promotion continues to be the nodal authority to oversee all FDI proposals in India. For example, the Department of Pharmaceuticals is the relevant administrative authority for FDI proposals in the pharmaceutical sector and will examine FDI proposals in brownfield pharmaceutical companies exceeding 74 per cent.

Tender offers and going-private transactions are heavily regulated, and timelines are driven largely by procedural requirements under law. Tender offers in India are required to be completed within 57 SEBI working days of the public announcement being made. However, tender acquisitions of public listed companies often take anywhere between three and four months on account of regulatory requirements and general complexities involved in transactions of such scale. The timeline may further be prolonged if there is a competing offer. The delisting process in a going-private transaction is required to be completed within 76 SEBI working days of board approval. However, the entire delisting process ordinarily takes around four to six months, and may be prolonged further if the acquirer seeks to squeeze-out minority shareholders and convert a public company to a private company.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

The SEBI's delisting regulations prescribe several checks and balances that ensure a fair delisting process. Firstly, delisting requires approval of the company's shareholders by a special resolution in addition to board approval. For purposes of the delisting regulations, approval of the delisting by a special resolution excludes the shares held by the company's promoters and considers the shares held by the company's public shareholders only. The number of votes cast by public shareholders in favour

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of delisting should be at least twice the number of votes cast against the delisting. This exclusion ensures a fair and unbiased review of delisting terms, as promoters, who typically hold a majority of the company's shares, are unable to exert undue influence on the decision to delist the company's shares.

Second, the delisting regulations grant dissenting shareholders an exit opportunity for up to one year to tender their shares to the acquirer after the company's shares have been delisted.

Thirdly, the final offer price in a delisting offer is determined through a reverse book building process where the final offer price is the price at which shares accepted in the offer achieve the prescribed delisting threshold of 90 per cent of the total issued capital. As the final offer price is subject to the number of shares required to achieve a successful delisting offer, the offer price can be substantially impacted by shareholders with substantial holdings in the company. This acts as a further deterrent to promoters, as the price determination process ensures that public shareholders are treated fairly.

Upon delisting of the company, an acquirer that desires to take the company private will need to seek conversion of the company from a public company to a private company. The conversion process requires an amendment to the company's charter documents, which can only be approved by a special resolution of the company's shareholders.

There are limited options for acquirers to address the risks associated with shareholder dissent, as the delisting process is meant to be fair to, and protect, public shareholders. A widespread issue faced by acquirers in going-private transactions is the presence of several minority shareholders even after completion of the delisting process. While minority shareholders cannot ordinarily interfere in the operation and management of companies, they can be an impediment to a company's functioning. A common problem faced by acquirers in going-private transactions is the inability of majority shareholders to approve bona fide related-party transactions on account of a significant number of minority shareholders preventing business from being conducted. In such cases, acquirers are forced to squeeze out minority shareholders. Squeeze-outs are relatively unevolved in India. There are limited options available to majority shareholders to force a squeeze-out in a manner that will be favourable with the minority shareholders and also applicable regulators. Majority shareholders were often forced to implement court-sanctioned minority squeeze-out schemes where the company's share capital is reduced selectively. In addition to being a drawn-out process, the price offered by the company in such schemes of capital reduction will almost always have been higher than the price offered to shareholders in the delisting process. Recently, however, the Indian government has notified certain provisions of CA2013 relating to the squeeze-out of minority shareholders without the involvement of courts. Majority shareholders who own 90 per cent or more of a company's share capital may now offer to buy out minority shareholders at a price determined by a registered valuer. Minority shareholders are also permitted to offer to sell their holdings to the majority shareholders at the price determined as above, irrespective of an offer having been made by the majority shareholders. The recently notified provisions also permit minority shareholders to participate in upside sharing on any future deal for the sale of shares by the majority shareholders at a price that is higher than the price offered to the minority shareholders, subject to the holders of at least 75 per cent of the minority shareholding agreeing to renegotiate the buyout price.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Other than adaptations for Indian law, the fundamental provisions of PE transaction documents are largely the same as the corresponding provisions of PE transaction documents for investments in the United Kingdom or the United States. Purchase agreements involving PE transactions are customarily buyer-friendly.

Transaction documents customarily include extensive representations and warranties (R&Ws) on corporate existence, power and authority, business and operations of the target company, financial statements, financial indebtedness, absence of material adverse change, compliance with laws, validity of licences and approvals, intellectual property, labour, real property, and, in the case of certain foreign PE investors, anti-corrupt practices. These R&Ws are sought from both the company and its promoters or selling shareholders, depending on the nature of the transaction. R&Ws are backed by indemnities, which are lately also being underwritten with R&W insurance. Specific disclosures and material due diligence issues are addressed with specific indemnities with no or very few limitations. Indemnity provisions are the subject of much negotiation. Parties agree on multiple limitations on indemnification, including caps on liability, de minimis and basket thresholds, survival periods for making claims, and offsets against recoveries through insurance, etc. Fundamental R&Ws (power and authority, and title to shares, etc) and R&Ws pertaining to taxes are carved out from the survival period for other R&Ws. Target companies and promoters resist perpetual indemnification obligations, and survival periods depend on the period for which the company has been in existence.

PE investors are reluctant to give any R&Ws pertaining to a company's business in stake sales of portfolio companies. R&Ws are limited to the investor's ability to conclude the transaction and its title to the shares being sold. There are limited instances where PE investors agree to give R&Ws on the company's business, and such provisions are commonly found in buyout transactions where an existing investor controls the portfolio company or plays an active role in its management. Indemnities are typically limited to breaches of the limited R&Ws provided by the PE investor, and are often underwritten by insurance. In certain transactions involving the sale of shares by a foreign PE investor to another foreign PE investor, indemnities for any indirect transfer taxes become a vital component of the share purchase agreements. Buyers usually agree to robust tax indemnities for transfer taxes, which are underwritten by insurance and, at times, a guarantee from the seller's general partner. Provisions relating to holdback of consideration for potential claims are also common, and are accompanied with escrow agreements to document conditions and processes for the release of holdback consideration.

PE transactions concerning public listed companies often contain limited R&Ws. Promoters agree to indemnify a limited extent of all claims citing their limited control of operations in spite of majority ownership. As leverage buyouts are not permitted in India, provisions pertaining to acquisition financing are rare, and are usually limited to comfort letters from limited partners or soft commitments of other offshore sources of finance.

Almost all PE transactions contain restrictive covenants on promoters, and in limited instances, PE investors. Non-compete provisions are generally not enforceable in India, unless reasonable in scope or in cases where the goodwill of a business is being sold along with the company's shares. In buyouts and going-private transactions, ownership and usage of intellectual property post-acquisition becomes relevant. In addition, acquirers often insist on a transition period where promoters continue to be associated with the company to ensure a smooth operational transition.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

Indian companies are mostly promoter-owned and controlled. PE investors prefer that promoters and their key managerial personnel continue, post-acquisition, to be involved in the management and operation of companies. Promoters maintain executive roles in the company. Therefore, the transaction documents for PE transactions often contain restrictive covenants regarding competition, solicitation and confidentiality.

Promoters and other key managerial personnel are compensated in the form of earn-outs, equity incentive schemes and other similar milestone-based compensation schemes. Such compensation packages are in addition to any consideration such individuals receive for the sale of their holdings in the company pursuant to a PE transaction.

As discussed in question 7, in listed company acquisitions and going-private transactions, promoters and key managerial personnel have defined transitional periods requiring them to remain committed to the company to ensure a smooth operational transition. Such arrangements are of particular relevance in service-based businesses

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where key customer relationships must be handed over to new management. Most such transactions do not involve the replacement of the company's management in its entirety. Several key existing managerial personnel continue to remain employed by the company post-acquisition, as such individuals remain fundamental to the continued growth of the company.

In all of the above, discussions with promoters and the existing management begin in advance of transaction documentation, and are often documented as conditions to transaction closure. Employment and other agreements are executed either at or prior to closing.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

There are specific pricing provisions governing Indian companies and investors that require primary investments to be priced appropriately. From a target's perspective, if shares are issued to resident investors at a price higher than the fair market value, as determined on the basis of specific formulae prescribed by tax laws, the target will be charged (subject to certain exceptions) to tax on the excess so received as income in its hands. Lately, Indian tax authorities have been examining share premium charged by Indian companies on the allotment of shares to non-residents also, and are attempting to tax Indian companies on excessive share premium. A valuation report from an independent reputed valuer supporting a share allotment and the premium charged is advisable.

Primary investments in closely held Indian companies are not taxable in the hands of investors, unless, in case of equity and preference shares, such shares have been acquired below fair market value. In such cases, the investor is taxed on the difference between the acquisition price and the fair market value of the shares, as the difference is treated as income in the hands of the investor. There was previously ambiguity on whether the conversion of convertible instruments into equity shares would be taxable in the hands of the instrument holder. Only the conversion of convertible debentures was specifically exempt under Indian tax laws. However, the Indian government introduced a specific provision to exempt the conversion of convertible preference shares into equity shares from capital gains tax under Indian tax laws from 1 April 2017 onwards.

A non-resident investor will be taxed in India, subject to relief as available under the relevant tax treaty between India and the country of residence of the investor.

Gains on transfers of shares are taxable at rates based on the period of holding, the type of holder, the type of company, and in the case of transfers of shares of listed companies, whether the shares are transferred on-market or off-market. Transfers include transactions such as share buybacks and redemptions. In unlisted companies, gains are treated as short-term if shares are held for a period of up to 24 months, and long-term if shares are held for a period of more than 24 months. For non-resident sellers (other than foreign portfolio investors (FPIs)), such short-term gains are taxable at 40 per cent in the case of corporate entities and 30 per cent in all other cases; and long-term gains are taxable at 10 per cent for all types of non-resident taxpayers. The 10 per cent concessionary tax rate for long-term capital gains on the transfer by non-resident taxpayers of shares of unlisted companies was introduced in the Finance Act 2016, pursuant to a clarification announced by the Indian government in the 2016–17 Union Budget. There was uncertainty about the effective date of the above amendment to Indian tax laws. However, the Indian government clarified in the 2017–18 Union Budget that the above concessionary tax rate would apply with retrospective effect from the 2012–13 financial year onwards. In listed companies, gains are treated as short-term if securities (including shares) are held for a period of up to 12 months and long-term if securities (including shares) are held for a period of more than 12 months. If the shares are sold on-market, such short-term gains are taxable at 15 per cent and long-term gains are tax-exempt (subject to certain conditions). The 2018–19 Union Budget has proposed to tax long-term gains in excess of 1 million rupees at 10 per cent, provided that securities transaction tax is paid at both the time of acquisition and disposal. On-market transfers are also subject to payment of securities transaction tax of 0.01 to 0.125 per cent, based on the type of on-market transaction. In off-market transfers, short-term gains are taxable at 40 per cent in the case of corporate entities, and 30 per cent in all other cases, and long-term gains are taxable at 10 per cent.

Note that all of the above capital gains tax rates are exclusive of applicable surcharges and education levies.

The Indian government has also introduced two anti-abuse measures on taxation of capital gains on the transfer of shares. First, long-term capital gains tax on the sale of equity shares acquired on or after 1 October 2004 will be exempt only if the acquisition of such shares was chargeable to securities transaction tax. The Indian government has notified certain transactions that are exempt from this requirement (such as the acquisition of shares under the FDI route, and the acquisition of shares pursuant to a court order, etc). Second, for the computation of capital gains on the transfer of shares of unlisted companies, if the consideration for such transfer is less than fair market value, as determined on the basis of specific formulae prescribed by tax laws, such fair market value shall be deemed to be the full value of consideration received for purposes of computing capital gains. A similar anti-abuse provision also applies to transfers of immovable property of a value less than the value determined for the computation of stamp duty.

Additionally, capital gains on the transfer of shares of a foreign company are subject to tax in India, subject to certain exemptions, if the shares of the target foreign company derive their 'value substantially' from Indian assets (ie, the value of such assets represents at least 50 per cent of the value of all the assets owned by the target foreign company and exceeds 100 million rupees). The value of such Indian assets as well as all the assets owned by the foreign company is determined on the basis of specific formulae prescribed by tax laws. Indian tax laws also prescribe additional disclosure requirements in multilevel holding structures to facilitate such determination.

Transfers by non-resident sellers to resident buyers or non-resident buyers are subject to withholding of the requisite amount of capital gains tax. Non-resident investors, other than registered FPIs, may also be subject to lower tax rates depending on their eligibility to claim benefits under the applicable tax treaty between India and their country of residence. Registered FPIs are subject to a special tax regime under Indian tax laws. Indian tax laws also prescribe additional disclosure requirements in multilevel holding structures to facilitate such determination. The above indirect transfer provisions do not apply on the transfer of investments made by a non-resident investor in shares of or interest in an entity registered as a Category-I or Category-II FPI (ie, a foreign institutional investor registered as a sovereign fund or an accredited private equity fund). The above exemption has provided foreign investors with much needed relief from indirect transfer taxes.

Non-resident sellers were historically exempt from paying capital gains tax if their investments were structured through jurisdictions having a favourable double taxation avoidance agreement with India. Mauritius, Singapore, Cyprus and the Netherlands were the most popular jurisdictions for PE investors to invest into Indian companies, as capital gains and dividends are not taxable and income tax rates are low. India has recently amended its double taxation avoidance agreements with Mauritius, Singapore and Cyprus to be able to tax capital gains arising out of direct disposal of Indian assets. These are key jurisdictions from which substantial foreign investment has been received in the last few years. Equity shares acquired prior to 1 April 2017 by PE investors based in Mauritius, Singapore and Cyprus will continue to be tax-exempt. Equity shares acquired by PE investors based in Mauritius and Singapore on or after 1 April 2017 but transferred prior to 1 April 2019 will be taxed in India at 50 per cent of the applicable domestic Indian capital gains tax; and on or after 1 April 2017 but transferred on or after 1 April 2019 will be taxed at full applicable domestic Indian capital gains tax. Equity shares acquired by PE investors based in Cyprus on or after 1 April 2017 will be taxed at applicable domestic Indian capital gains tax. Compulsory convertible debentures and non-convertible debentures are exempt from capital gains tax for investors based in Mauritius, Singapore and Cyprus.

The Indian government has introduced General Anti-Avoidance Rules (GAAR) from 1 April 2017. It is now imperative to demonstrate that there is a commercial reason, other than for obtaining a tax advantage, for structuring investments out of tax havens. GAAR can be used to challenge arrangements with the main purpose of obtaining a tax

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benefit and deny benefits otherwise available under a tax treaty. Income arising from the transfer of investments acquired before 1 April 2017 have been 'grandfathered' from the applicability of GAAR.

Further, a foreign company is to be treated as tax resident in India if its place of effective management (PoEM) is in India. PoEM is 'a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made'. If the foreign company becomes resident in India, it would be taxed at an effective rate of 41.2 to 43.26 per cent on its global income in India. Accordingly, PE investors must exercise caution while structuring their fund management structures, and in some cases their investments, in Indian companies.

Indian companies, irrespective of their ownership and control, continue to be taxed in India on their corporate income at a rate of 30 per cent (exclusive of applicable surcharges and levies). As an incentive to start-ups and medium scale companies, the Indian government announced in the 2017–18 Union Budget that the rate of income tax for companies with a turnover of up to 500 million rupees in the previous financial year will be 25 per cent instead of 30 per cent (in each case exclusive of applicable surcharges and levies). Dividend distribution tax (DDT) at an effective rate of 20.357 per cent (computed on a gross-up basis) is payable by Indian companies on the amount of profit distributed to its shareholders and no further tax is payable by the recipients of the dividend (subject to certain exceptions in the case of non-corporate resident taxpayers). DDT is payable by every company in India. Multilevel structures will result in DDT being payable by each company while upstreaming dividends to the ultimate parent company. An exemption from this cascading effect of DDT is available only if a parent company in the structure holds more than 50 per cent of its immediate subsidiary (the parent company may avail of the exemption regardless of the extent of shares held by its shareholders); and if dividends are distributed by such parent company from dividends received from its immediate subsidiary in the same financial year when they are received, provided the same amount of dividend shall not be taken into account for reduction more than once.

Indian companies are also required to pay minimum alternate tax (MAT) on the basis of profits disclosed in their financial statements. MAT is payable by companies based on their 'book profits', calculated in a prescribed manner, at an effective rate of between 19.06 and 21.34 per cent when the tax liability of the Indian company computed under normal provisions of Indian income tax laws is below 18.5 per cent. MAT is applicable to Indian companies and also to foreign companies in certain circumstances, subject to exemptions on certain specified streams of income for foreign companies. The applicability of MAT to foreign companies was controversial until a recent clarification in Indian tax laws, and judicial pronouncements clarified that foreign companies shall not be subject to MAT where:

- the country of residence of the foreign company has signed a double taxation avoidance agreement with India and such company does not have a permanent establishment in India under such agreement; or
- the country of residence of the foreign company has not entered into a double taxation avoidance agreement with India and such company is not required to seek registration in India under any applicable law.

Interest income on Indian rupee-denominated debt is subject to withholding tax at a rate of 40 per cent, unless the debt investment is structured through a tax-friendly jurisdiction and the borrowing is structured as a bond with an interest rate that is below a prescribed rate. In such cases, the withholding rate can be reduced to 5 per cent if such bonds are issued prior to 30 June 2020. Debt investments by PE investors through NCDs and 'masala bonds' are tax-friendly as a result. Interest income on foreign currency debt is subject to withholding tax at a rate of between 5 and 20 per cent, depending on several factors. As Indian laws do not permit PE investors to avail of domestic acquisition financing, PE investors are not ordinarily subject to withholding tax in India. With effect from 1 April 2017, NCDs issued to investors based in Mauritius will enjoy a 7.5 per cent withholding tax rate on interest income, as compared to 15 per cent for those based in Singapore and 10 per cent for those based in Cyprus.

Employees in India are subject to individual income tax at varied slabs. Indian income tax laws follow a progressive slab rate for individuals. The highest slab rate is 30 per cent (exclusive of applicable surcharges and levies). Income received pursuant to the exercise of stock options, severance payments and golden parachutes are taxed as salaries. Indian tax laws do not permit parties to treat share purchase transactions as asset acquisitions.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

The RBI prohibits Indian banks from granting loans for purposes of the acquisition of shares. Only non-banking financial companies may lend monies for purposes of acquisition financing. However, borrowing costs and limitations on the extent of leverage that may be availed prevent PE investors from borrowing from such institutions. Any form of acquisition financing is limited to offshore sources, which can be problematic given restrictions on the creation of security on Indian assets in favour of non-resident lenders. Indian exchange control regulations prohibit Indian parties from pledging their shares in favour of overseas lenders if end use of the borrowing is for any investment purposes directly or indirectly in India. Structures using Indian companies that are owned or controlled by foreign investors are also not feasible, as such companies are prohibited from raising any debt from the Indian market to make any further downstream investments. Public companies (including private companies that are subsidiaries of public companies) are not allowed to provide any security or financial assistance for the acquisition of its own securities. The assets of such Indian companies cannot be leveraged for the purposes of acquisition financing as a result.

Privately placed NCDs are a popular form of debt financing for foreign PE investors. NCDs are less regulated than overseas loans, and can be secured by Indian assets, as applicable regulations mandatorily require the appointment of an Indian debenture trustee to hold security on behalf of the debenture holders. There are no caps on the returns a PE investor can make on NCDs. NCDs issued to FPIs are no longer mandatorily required to be listed and are liquid instruments in the hands of the PE investor. Further, as there are limited end use restrictions on privately placed NCDs, PE investors may consider investing in such instruments to finance domestic acquisitions.

An emerging form of debt financing is the use of masala bonds. Masala bonds were notified by Indian regulators in September 2015, and are Indian rupee-denominated debt instruments that may be issued to overseas lenders. As such instruments are denominated in Indian rupees, overseas lenders are expected to bear the risk of exchange rate fluctuations. Since their introduction. PE investors have not used masala bonds to finance domestic acquisitions. This is largely owing to a prevailing view that proceeds raised through the issuance of masala bonds cannot be used for capital markets and domestic equity investments. In addition, Indian regulators introduced additional conditions on the issuance of masala bonds in 2017 that have reduced the flexibility to structure such investments. For example, all masala bond issuances now require prior RBI approval.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

As acquisition financing is generally not permitted in India, the transaction documents for going-private transactions typically do not contain provisions relating to debt or equity financing. However, it is fairly commonplace for transaction documents to contain R&Ws made by PE investors about their financial wherewithal and bona fide sources of funds. In auction processes and large transactions, it is common for the seller to request for equity commitment letters or financing arrangements to demonstrate the purchaser's ability to perform its obligations.

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12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Fraudulent conveyance and other bankruptcy issues do not arise in light of our responses relating to restrictions on acquisition financing. However, PE transactions typically contain R&Ws on solvency.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements contain customary minority protection rights, such as information rights, corporate governance rights (board seats, affirmative voting rights, veto rights, etc), restrictions on transfer of shares (including lock-in restrictions, rights of first refusal or rights of first offer, co-sale rights, etc), anti-dilution protection, pre-emptive rights on future capital issuances, exit rights (IPOs, buyback options, put options, etc), liquidation preference and drag-along rights.

Under law, minority shareholders holding more than 25 per cent of the voting rights of a company have the power to block all special resolutions. Approval by a special resolution is required for all material corporate actions, including certain share issuances, alteration of charter documents in certain cases, and winding up, etc. Further, the holders of 10 per cent or more of the share capital of a company, or of 10 per cent or more of the total number of members, or 100 or more members, can initiate proceedings against the company or its shareholders for oppression or mismanagement or both.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

The acquisition of control of Indian companies may be regulated or restricted on account of regulations relating to tender offers in listed company acquisitions, and exchange control regulations relating to FDI in sectors having investment caps.

Under tender offer regulations, any acquisition of shares or voting rights entitling the acquirer (along with persons acting in concert) to exercise 25 per cent or more voting rights in a public listed target company requires such acquirer (and the persons acting in concert) to make an offer to the public shareholders to acquire at least 26 per cent of the voting shares of the target company. Tender offer regulations also prescribe other means of consolidation in case an acquirer already holds a substantial stake in the target company, including norms relating to creeping acquisitions where up to 5 per cent of the voting rights in a target company may be acquired in a fiscal year. That said, the tender offer regulations also set out certain acquisitions that are exempted from the requirement to make a tender offer. Examples include acquisitions pursuant to a scheme or arrangement pursuant to an order of a court or a tribunal or a governmental authority, and acquisitions of stressed companies pursuant to a resolution plan approved under the recently notified Insolvency and Bankruptcy Code 2016.

Under Indian exchange control regulations, FDI in certain regulated sectors is not permitted beyond a specified limit. For example, FDI in the insurance sector is limited to 49 per cent. Further, under exchange control regulations, downstream investments by an Indian company that is not owned or controlled by resident Indians are considered as downstream foreign investments. PE investors looking at control or ownership of Indian companies have to be cognisant of this requirement, as Indian business groups with multiple subsidiaries engaged in activities falling under different sectors for purposes of FDI will need to comply with sectorial caps and investment conditions, including pricing and valuation guidelines, prescribed under Indian exchange control regulations in respect of each such subsidiary.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Private sales and IPOs are the preferred modes of exit for PE investors in India. IPOs continue to be the exit route of choice for most PE investors, given larger access to capital in international and domestic public markets and free transferability of shares.

Limitations on private sales of unlisted Indian companies are largely contractual. Transfer restrictions under shareholders' agreements and charter documents, such as rights of first refusal, rights of first offer, co-sale rights, and put and call options, etc. In the absence of such restrictions, there are limited legal restrictions prescribed under Indian laws. Pricing guidelines under Indian exchange control regulations must be followed in a private sale to or by a non-resident. A sale of shares by a resident to a non-resident cannot be effected at a price that is lower than the fair value of the shares of the portfolio Indian company, as determined by a chartered accountant or merchant banker based on an internationally accepted valuation methodology on an arm's-length basis. The above floor price operates as a cap in a transfer of shares from a non-resident to a resident. No such pricing restrictions apply to a transfer of shares by a non-resident to another non-resident. In a private sale of shares of a listed company, the benchmark price is the price at which a listed company may undertake a preferential allotment of securities under applicable SEBI regulations. Foreign venture capital investors registered with the SEBI are exempt from entry and exit pricing guidelines. In PE investments where non-residents have been granted put or call options, the shares held by such non-residents are subject to a lock-in period of one year from the date of acquisition of such shares. In addition to pricing guidelines, sectorial conditions and investment caps presented under FDI laws apply to sales of portfolio companies. Further, both the buyer and seller must be cognisant of antitrust issues and potential antitrust filings if certain thresholds relating to assets and revenues are met or if the transaction is likely to have an appreciable adverse effect on competition in India.

IPOs are the exit method of preference for PE investors. Almost all shareholders' agreements obligate the company and its promoters to provide PE investors with an exit through an IPO within a defined timeline. IPO clauses in shareholders' agreements prescribe that the IPO must either be an offer for sale of existing shares or a combination of a fresh issue of shares and an offer for sale. PE investors negotiate that they will have priority to offer up to all their shares as part of an offer for sale. IPO clauses also prescribe a minimum valuation at which the IPO must be undertaken for it to be considered a successful exit. PE investors typically include veto rights on key components of the IPO process, including timing, pricing, the appointment of merchant bankers, and the stock exchange for listing of shares. These obligations and conditions, however, are not entirely binding on the company and the promoters, as IPOs are largely market-driven. Obligations to conduct an IPO are usually on a best-efforts basis as a result. It is, therefore, difficult for PE investors that own minority stakes and do not control management to demand an IPO and force the process. In addition, as the IPO offer document is to be signed by all the company's directors, the fiduciary duties of directors may not permit the company to undertake an IPO on terms prescribed by PE investors if the directors feel that the IPO is not in the best interests of shareholders. The enforceability of IPO provisions in shareholders' agreements remain largely untested by Indian courts.

An IPO through an offer for sale is treated similarly to an IPO by way of a fresh issuance under applicable SEBI regulations. The company must have a track record of profitability and net worth, and minimum net tangible assets, etc. While these conditions need not be satisfied in certain cases, Indian companies focused on e-commerce and technology, and start-ups may not be able to satisfy such conditions. Exits by PE investors from such companies through an IPO may be hindered as a result.

In addition, PE investors must be cognisant of being named as 'promoters' in an IPO. PE investors with substantial stakes or considerable operational control may be named as 'promoters' in the offer

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document. A 'promoter' for the purposes of an IPO is subject to several responsibilities and obligations, including a three-year lock-in on its shares. One hundred per cent of the promoters' shares are locked in for one year post-IPO. Thereafter, the minimum promoters' contribution (ie, at least 20 per cent of the post-issue share capital) is locked in for a further period of two years. All shareholders are subject to a one-year post-issue lock-in, except stock option holders who have been allotted shares prior to the IPO and certain registered domestic and foreign venture capital investors who have held shares in the company for at least one year prior to the date of filing of the draft offer document. Companies with majority PE ownership often do not undertake an IPO owing to the above restrictions, and look at secondary sales as preferable means of exit.

PE investors are reluctant to provide post-closing recourse to buyers. In most cases, recourse is limited to indemnities for breach of fundamental R&Ws and tax claims on share transfers. See question 7 for further information on the nature of such R&Ws, indemnities and other customary protections.

Upside sharing arrangements that a PE investor may enter into with promoters, directors or key employees of listed companies to incentivise them and share returns beyond a hurdle rate require disclosure to stock exchanges and prior approval of the board and public shareholders. Promoters and interested shareholders are not permitted to vote on such matters.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Public offers in India are primarily regulated by CA2013 and the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. Stock exchanges grant listing approval only if special or additional rights available to shareholders under the company's charter documents are removed prior to listing. Typically, PE transaction documents do not contemplate the survival of any rights post-IPO. However, it is not uncommon to negotiate certain governance rights to continue post-IPO. PE investors often negotiate for a board seat or an observer right to survive post-IPO. Similarly, veto rights in certain cases have been known to survive post-IPO. There is ambiguity under Indian law as to the nature of veto rights. Negative control and positive control have not been clearly distinguished, and there is no definitive judicial pronouncement on this subject. In any case, any veto rights that stock exchanges do permit to post-IPO are limited to actions affecting a PE investor's investment in the company.

See question 15 on the lock-in restrictions applicable in connection with an IPO. In addition, Indian exchange regulations prescribe certain lock-in restrictions for FDI in certain limited sectors or in certain situations. For example, FDI in construction and development projects is subject to a lock-in of three years.

Post-IPO, PE sponsors may sell their shares either through negotiated deals either on or off market. In on-market negotiated deals, SEBI regulations permit 'block' and 'bulk' deals. Such transactions must take place during specified times and up to specified volumes or value. The ruling market price of the shares would be the purchase price in such transactions, except in a block deal where the price should not exceed 1 per cent above or below the applicable reference price. FDI is not permitted through on-market transactions, unless the non-resident investor has acquired, and continues to hold, control of the target company and satisfies certain other conditions (including those stated above). Off-market transactions may take place at a negotiated price, subject to compliance with pricing guidelines prescribed under Indian exchange control regulations in case of a non-resident seller or buyer. In both cases, parties should keep applicable tender offer and antitrust regulations in mind while structuring such transactions. See question 3 on insider trading issues on disposal of shares where a PE investor continues to have a board representation or otherwise has material price sensitive information.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Post-liberalisation of the Indian economy, the information technology and information technology-enabled services sectors have attracted the most attention from PE investors. Having said that, manufacturing, financial services, banking services, healthcare, consumer goods, real estate and pharmaceuticals have also witnessed several landmark PE investments. E-commerce and consumer start-ups have seen a lot of PE activity lately. It is expected that healthcare and allied services, financial technology, non-renewables and green energy will be the next big sectors.

Indian exchange control regulations prescribe entry routes for FDI by setting out activities undertaken by companies in India that are prohibited from receiving FDI, that may receive FDI, subject to prior regulatory approval, and may receive FDI without any approvals (ie, the automatic route). These regulations also prescribe sectoral caps and conditions to be satisfied for FDI in certain sectors. Potential investment targets may be limited on account of Indian exchange control regulations prescribing sectoral conditions, investment caps, lock-in restrictions or minimum capitalisation.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Cross-border going-private and PE transactions are subject to the considerations described in questions 1 and 9. The primary considerations for structuring cross-border transactions are Indian exchange control regulations and tax implications.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Club or group deals are on the rise in India. Inter se rights of the PE investors and alignment of their objectives are the principal considerations in group deals. Shareholders' agreements, including rights relating to exit, transfer restrictions, liquidation preference, anti-dilution protection, corporate governance and veto rights, should be carefully drafted to avoid potential conflicts among PE investors. Additional complications may arise when such transactions are structured among financial and strategic investors. As the objectives of financial and strategic investors are fundamentally different, the interplay of their individual rights, particularly in case of exit rights and transfer restrictions, is of great importance. Although uncommon, several Indian companies have attracted investments from multiple strategic investors. In such group deals, due consideration must be given to rights affecting the ability of each strategic investor to acquire further shares in the company.

Consortium deals also need special review from an antitrust perspective since existing investments of the consortium members may give rise to substantive competition issues if there are overlaps with a target's business.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Most closing conditions usually relate to due diligence issues that need to be addressed prior to a PE investment. Having said that, promoters, selling shareholders and companies are reluctant to have extensive closing conditions, and negotiate extensively to limit closing conditions to fundamental issues only. Legal and regulatory conditions on account of Indian exchange control regulations, tax laws, and sector-specific regulations are unavoidable and usually non-negotiable. Similarly, buyers insist on the inclusion of third-party consents, such as lender consents.

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In listed company transactions, closing conditions are often limited to legal and regulatory conditions, and key consent requirements. Any due diligence specific conditions are addressed separately prior to the execution of transaction documents and are not mentioned in the transaction documents.

A buyer is not obliged to invest upon a failure to fulfil closing conditions, and is usually granted the unilateral right to terminate transaction documents and walk away from the transaction. Conversely, sellers may seek either specific enforcement of closing or seek damages from a buyer, if a buyer does not intend to invest upon fulfilment of closing conditions. Break or termination fees, although uncommon in Indian transactions, may also be negotiated, particularly in auction deals, and such amounts are typically held in escrow or provided as a guarantee until closing.

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Indonesia

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Indonesia's private equity market is relatively small compared to the more developed markets of China and India. The private equity capital is also relatively low relative to the country's overall economy and the size of the stock market.

Private equity transactions in Indonesia commonly utilise mezzanine debt instruments, convertible debt instruments and equity purchase, as well as financing based on profit or revenue sharing.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Indonesian law does not recognise specific corporate governance rules for private equity business activities. Law No. 40 of 2007 on the Limited Liability Company (the Company Law) has guidelines relating to corporate governance in general. Corporate governance rules are only mandatorily adopted in certain sectors, particularly commercial banking, financial services, publicly listed companies and also for state-owned entities. Therefore, since it is not generally applicable for all sectors, a private equity company may adopt its own corporate governance rules which should be in line with the Company Law and it may be attractive to investors and can increase the accountability of the fund management once the company becomes a public company.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

There is a high bar to clear to complete a 'going-private' process (ie, where the intention is to no longer be a public company and no longer be subject to various capital market regulations) and the capital market authority is generally reluctant to allow delisting.

In many cases of voluntary delisting, the delisting is carried out with a going-private plan. The decision of the Jakarta Stock Exchange (currently known as the Indonesian Stock Exchange) No. 1-1 on the Delisting and Relisting of Shares in the Stock Exchange provides that to delist its shares to the stock exchange, a company must obtain an approval from its general meeting of shareholders (GMS). In cases where companies delisted and went private (eg, PT Bank Ekonomi Raharja, PT Merck Sharp Dohme Pharma and PT Unitex), they were required by Indonesia's capital market regulator, the Financial Service Authority (OJK), to achieve an approval from a quorum of at least 75 per cent attendance of total independent shareholders and simple majority approval of the independent shareholders.

Regulation No. 1-1 also requires the company or other party to purchase all shares of shareholders who reject the approval for delisting at the minimum price as stipulated in the regulation.

In addition, an extensive disclosure requirement, tender offer of the remaining shares and stock exchange rules with respect to delisting would need to be followed. In practice, public-to-private transactions are not common in Indonesia.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

A public company that intends to go private must first submit a letter to the OJK, with a copy going to the stock exchange, regarding its intention and its reason for doing so.

The going-private process can potentially be deemed as a conflict-of-interest transaction, in which case it requires the relevant parties to follow procedures regulated under Regulation No. IX.E.1 on Affiliated Transaction and Conflict of Interest of Certain Transaction attached to the Decision of the Chairman of Bapepam (now the OJK) No. KEP-412/BL/2009 (Regulation IX.E.1). Such procedures are, among other things, to obtain the approval of independent shareholders and an independent party rendering an independent opinion. After all of the procedures are complied with, the going-private process must follow OJK Regulation No. 54/POJK.04/2015 dated 23 December 2015 on Voluntary Tender Offers.

Based on Law No. 8 of 1995 on Capital Market, and its implementing regulations on disclosure of information (OJK Regulation No. 31/POJK.04/2015 dated 16 December 2015 on Disclosure of Information or Material Fact by Issuer or Public Company), the public company must report to the OJK and publicly announce its decision to go private within two business days as of the material fact that the decision has been made.

Once the company has changed its status from public to private, article 62 of Company Law will apply to the public shareholders who do not want to sell their shares through a tender offer. The company must buy their shares at par value. This requires dissenting shareholders to be bought out after a resolution of a general meeting of shareholders.

Conflict of interest

In order to go private, a public company must comply with Regulation IX.E.1, which defines a conflict of interest as 'the difference between the company's economic interests and the economic interests of its directors, commissioners, main shareholders or affiliates'.

The public company must obtain independent shareholder approval in a general shareholders' meeting and must provide the following, among other items:

- a description of the transaction including the following:
  - the transaction to be undertaken (ie, to go private);
  - the value of the transaction;

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  - the names of the parties conducting the transaction and their relationship with the company; and
  - the nature of the conflict of interest of the parties involved in the transaction;
- a summary of the appraiser's report including the following:
  - the identity of the parties;
  - the valuation object;
  - the purpose of the valuation;
  - the assumption;
  - the approach and valuation method;
  - the concluded value; and
  - the opinion on the fairness of the transaction;
- a description of the general meeting of shareholders planned to be held if the required quorum of attendance by independent shareholders is not achieved at the first meeting, a statement on eligibility to vote on the proposed transactions and the required favourable votes at each meeting;
- explanations, considerations and reasons for the transaction to be conducted compared to a similar transaction that does not have a conflict of interest;
- a plan and data of the public company;
- a statement from the board of commissioners and the board of directors stating that all material information has been disclosed and the information is not misleading; and
- a summary or expert and independent consultation, if required by the OJK.

Generally, the GMS must be attended by more than 50 per cent of independent shareholders, and approved by more than 50 per cent of all shares held by the independent shareholders.

Tender offer

As part of the going-private process, the OJK requires the controlling shareholders to undertake a tender offer to buy out the public shareholders as stipulated under Regulation IX.F.1, which defines the term as 'an offer through mass media to acquire equity-linked securities (eg, shares) by purchasing or exchanging with other securities'.

Announcements

A party conducting a tender offer must announce its intention in at least two Indonesian-language newspapers, one with national circulation. The tender offer statement must comprise the following:

- the name and address of the target company;
- a detailed description of the shares that will be the object of the tender offer, comprising the following:
  - the price of the tender offer;
  - the time and date the tender offer will be conducted; and
  - the procedure of tender offer;
- requirements and conditions of the tender offer;
- the name of the stock exchange where the shares are traded;
- the calculation result of the price of the shares;
- the name, address and nationality of the offeror and its affiliation in relation to the tender offer and notification on whether any of the following relate to the offeror:
  - if he or she has ever been declared bankrupt;
  - if she or she has ever been a director or a commissioner guilty of causing a company to go bankrupt;
  - if he or she has been convicted of a financial crime; or
  - if he or she has been ordered by the court or any other authorised agency to stop activities in relation to the shares;
- the description on the relationship, contract and material transaction between the public company and its affiliations during the previous three years, for example, the following:
  - sale and purchase contracts;
  - agency relationship; and
  - management relationship;
- a statement from the offeror on the availability of sufficient funds to complete the tender offer supported by the opinion of the accountant, bank and securities company;
- a statement on the purpose of the tender offer and the plan for the company after the tender offer is conducted, including the plan to change the capitalisation structure, dividend policy and change of management;
- a description on the amount and percentage of shares owned directly or indirectly by the offeror including the option to buy or the right over dividends and other benefits and the power of attorney to vote in the GMS;
- a list of names and addresses of parties that receives a reward from the offeror in relation to the offer; and
- other material information.

Purchase price

Regulation IX.F.1 explicitly provides that the purchase price offered in the tender offer must be higher than the following:

- the highest tender offer price submitted by the same offeror during the 180 days prior to the date of announcement;
- if the tender offer is addressed to shares listed and traded on the stock exchange, the average highest daily market price in the stock exchange during the 90 days before the date of announcement;
- if the shares are not traded in the stock exchange during the 90 days before the date of announcement, the average highest daily market price in the stock exchange during the 12 months leading up to the shares' last day of trading; and
- if the tender offer is addressed to shares that are not listed in the stock exchange, a reasonable price decided by the appraiser.

If the board of directors or board of commissioners of the company undergoing the going-private process know, or have sufficient reason to believe, that the information stated in the tender offer is incorrect or misleading, then the company is obliged to make an announcement relating to its objection on the tender offer statement. The announcement must be made in at least two newspapers, one with a national circulation, at least 15 days prior to the end of tender offer period.

The offeror (ie, the controlling shareholder) is prohibited to buy or sell the offered equity-linked securities within 15 calendar days before the announcement of the tender offer plan, up to the end of the tender offer period.

From the date of the announcement of the tender offer plan up to the end of the tender offer period, the target company must not conduct any transactions aiming to prevent the change of the controlling party of the target company (as a result of the execution of the tender offer).

See also question 3.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Taking into account shareholders' meetings, tender offer processes, appraisal reports, conflict of interest disclosure and compliance and crossing via the stock exchange, a going-private transaction takes roughly around eight to nine months.

For private equity transactions, the rough timing would be around four to five months for equity and around three to four months for debt.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

See question 4.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

In order to keep up with the international standard, the following are the features that are frequently included in the governance agreement of private equity investments in Indonesia:

- conditions precedent for closing to ensure delivery of various original documents and corporate approvals are complete;
- representation, warranties and indemnities from the target company and seller in connection with the following:
  - due incorporation;
  - title warranties of shares; and

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- constitutional documents, registers, books and records. If the investor requests more, these may be expanded to include the following:
  - financial warranties;
  - financial indebtedness;
  - real property and leases (if applicable);
  - assets;
  - material contracts;
  - employees;
  - dispute proceedings;
  - tax warranties; and
  - anti-bribery or anti-corruption;
- covenants (positive) relating to various outstanding documents, actions, performances from the seller. Sometimes these may also be mentioned in the conditions subsequent;
- covenants (negative) relating to restriction to the seller such as non-solicitation, non-competition, non-disclosure, etc; and
- indemnity for non-compliance before closing.

In relation to tax, the seller provides certain representations and warranties to the purchase in relation to the condition of the stock or business asset, such as the following:

- the seller or the target company has paid all of its tax obligation to the government as of the execution date of the agreement and will provide the purchaser with a list of outstanding tax obligations that may incur in the future;
- in the event that, after the closing date, the result of the tax correction made by the authorised agency appears to be beyond the reasonable tax propriety, the seller agrees and binds itself to bear all of the payments in connection to such tax correction provided that such tax correction is resulted from the transaction completed by the target company prior to the closing date;
- the seller or the target company has made all returns, given all notices and submitted all computations, accounts or other information required to be made, given or submitted to any tax authority in accordance with the law and all such returns and other documentation were and are true, complete and accurate; and
- the seller or the target company has not carried out, been party to or otherwise been involved in any transaction where the sole purpose was the unlawful avoidance of tax or unlawfully obtaining a tax advantage.

In addition to this, the purchaser could also add a tax covenant from the seller to the purchaser as a schedule to the agreement. Aside from the representations and warranties clause itself, indemnity or the payment for misrepresentation or incorrect warranties is usually also regulated under the agreement. The parties to the agreement can state a certain amount of money as a remedy for such representations or incorrect warranties.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

Normally, the management of a target company is rather passive in a going-private transaction as the transaction is initiated by the controlling shareholder (or new controlling shareholder). In Indonesia, the principal executive compensation during the going-private transaction is generally not a major issue as unlike management of public companies in certain jurisdictions, the outstanding stock option for management would be minimal. The timing consideration is also an immaterial issue.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Normally the target is an Indonesian corporate tax resident that is subject to 25 per cent corporate income tax. The income tax is generally imposed upon the net profit (the revenue less allowable deductible expenses relating to generating taxable income including interest).

Interest tax relief for acquisitions can be obtained if the acquisition would result in the acquirer owning under 25 per cent in shares of the target company. However, the withholding of taxes on interest payment cannot be easily avoided. The debt to equity ratio (generally at 4:1) should also be observed in order to enable the interest relief to be obtained.

With regard to tax issues related to executive compensation, basically the compensation is treated as normal taxable income (the individual income tax rate is progressive from 5 per cent up to 30 per cent) when all conditions to receiving the compensation are met.

Share acquisition could not be classified as asset acquisitions for tax purposes.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Utilisation of debt is normally in the form of convertible bonds or loan plus warrants, which have a feature that may offer an alternative to an investor wishing to invest in a sector where certain equity limitations are imposed upon foreign ownership or to erode some of the investor's profits. The main issues would relate to the debt to equity ratio, security sharing, cross default and payment waterfall.

Any financial assistance offered by the company would be analysed from the prism of the ultra vires and corporate benefit limitations (ie, whether such financial assistance goes beyond the scope of the object and purpose of the company and whether such assistance benefits the company). Indonesian commercial banks are generally prohibited from providing loans to purchase shares for speculative purposes.

With regard to foreign offshore loans, Bank Indonesia imposes an obligation to apply the prudential principle for non-banking corporations. This prudential principle requires non-banking corporations to comply with the mandatory hedging ratio, liquidity ratio and credit rating. Although there are certain exemptions, in general, this policy creates a hurdle for using debt to finance going-private or private equity transactions.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Normally, the Asia Pacific Loan Market Association standard for facility agreement would be used as a reference for financing documentation. Standard provisions in the financing documentation would include definition, interpretation, purpose of the loan, conditions precedent to drawdown, events of default, collateral, representations and warranties, covenants, boiler plate provisions (notices, dispute resolutions, governing law, severability, language, etc) and countersign mechanism.

See also question 7.

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12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

The fraudulent conveyance would normally appear where the debt of the new controlling shareholder (which is used to finance the acquisition) is pushed down to the target company, which most of the existing creditors of the target company would object to. In the majority of such cases, the target and new controlling shareholder will re-negotiate with the existing lenders of the target and offer some sweetener to them (such as additional collateral, guarantee, etc). Furthermore, if the transfer of debt occurs within one year before the company's bankruptcy, such transfer of debt can be nullified if it is considered detrimental to the existing creditors on the basis of Indonesian fraudulent conveyance laws as stipulated under articles 41 and 42 of the Indonesian Bankruptcy Law and articles 1341 and 1454 of the Indonesian Civil Code.

Private equity firms may also invest in a special situation target (ie, a target facing financial difficulties, which may cause insolvency or substantial debt restructuring) to get the best price for its investment.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

The shareholders' agreements cover the agreed features between the shareholders (although sometimes the company signs and acknowledges this). The negotiable points commonly include the following:

- the shareholders' rights to nominate the members of the board of directors and board of commissioners;
- quorum and voting requirements for the GMS;
- details of reserved matters;
- pre-emptive rights and shareholders' loans;
- certain restrictions on the transfer of shares of the company (eg, rights of first refusal, rights to match, tag-along, drag-along, change of control, etc); and
- dispute resolutions (Mexican stand-off, Russian roulette, etc).

Indonesian company law provides certain protection to minority shareholders (depending on the shareholding percentage). The protection may include the following:

- rights to access the company's books;
- rights to request his or her shares to be bought back;
- rights to veto on certain corporate actions such as merger, liquidation, change of constitutional documents and disposal of material assets;
- rights to file court claims for damages against directors or commissioners;
- rights to seek dissolution of the company;
- rights calling a meeting of shareholders; and
- pre-emptive rights, etc.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

There are several procedures under the Company Law that must be observed in the event of acquisition. The takeover or acquisition of a controlling interest in any Indonesian company must be approved by its shareholders, be published in an Indonesian newspaper and requires settlement of objections that creditors may have. An abridged acquisition plan must be published in a newspaper and submitted to all employees. A complicated objection procedure applies: any creditor (which may include employees) may file objections to the board of directors, but if these are not settled they must be submitted to the shareholders' meeting that must approve the acquisition.

Further to the above, according to Government Regulation No. 57 of 2010 on Merger, Consolidation of Business Entity and Acquisition of Shares which may cause Monopoly Practice and Unfair Business Competition, there are certain reporting requirements for an acquisition (and subscription of shares) that results in a change of control of an Indonesian company (if certain thresholds are met).

In addition, as mentioned in question 5, investment in certain sectors (such as banking, insurance and finance) require prior approval from the relevant government authorities.

An approval from the Investment Coordinating Board would also be required in the case of direct investment by a foreign investor. This approval is commonly granted by taking into account the negative list, which is a list issued by the Indonesian government classifying business activities that are entirely closed or open for investment with certain conditions,for example, the following:

- limitations on foreign ownership;
- requirements for local partnership;
- limited permitted locations; and
- requirements of special licences or recommendation.

The position of listed companies and foreign ownership rules has been in a state of change for the past few years. Recently, based on BKPM Regulation No. 13 of 2017 concerning the Guidance and Procedures of Investment Licensing (Regulation 13/2017), which became effective on 2 January 2018, if a foreign investor purchases shares of a domestic investment company that has listed its shares in the Indonesian stock exchange, resulting in the name of said foreign investor being stated in the deed of such domestic investment company, then the legal status of such domestic investment company shall be changed into a foreign investment company. In practice, there are a number of precedents where publicly listed companies with a foreign shareholding (either directly or indirectly and non-portfolio) exceed the limitations set out under the negative list.

The source of funds to finance the investment can be from equity or a combination of equity and loan. A foreign direct investment is required to have the following:

- a minimum total investment (excluding land and buildings) of 10 billion rupiah;
- a minimum issued and paid-up capital of 2.5 billion rupiah; and
- a minimum share participation of a shareholder of 10 million rupiah.

Additional rules apply to public companies. Pursuant to Rule No. IX.H.1 on Public Company Acquisition, as attached to the Decree of Chairman of Bapepam-LK No. KEP-264/BL/2011 dated 31 May 2011, the transfer of shares of a public company leading to an acquisition results in the new controller having the following obligations:

- make an announcement to the public in at least one Indonesian daily newspaper with national circulation and notify the OJK at least one business day after the takeover (the takeover announcement), which, according to item 3.a.1 of Rule IX.H.1 includes the following information:
  - the total number of shares that have been acquired and total number of the new controller's shares;
  - the new controller's identity including name, address, contact details, line of business (if any) and the objective of the control; and
  - a statement declaring that the new controller is an organised group (only relevant if the new controller falls under the organised group definition);
- submit evidence of the daily newspaper announcement to the OJK within two business days of the date of the announcement;
- conduct a mandatory tender offer (MTO), according to item 3.a.2 of Rule IX.H.1. This MTO must extend to the shares owned by all shareholders other than those owned by the following:
  - any shareholder that has taken part in the takeover transaction with the new controller;
  - any other person that has already received an offer from the new controller with the same terms and conditions;
  - any other person who, at the same time, is making either an MTO or voluntary tender offer for the target company shares;
  - the 'primary shareholder'; and
  - another controller of the target company; and
- submit a report to the OJK and a public announcement on the acquisition, as required under OJK Regulation No. 31/POJK/04/2015 on Disclosure of Information or Material Facts By Public Listed Companies.

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15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Indonesia's capital market regulator has mandated minimum free float requirements (ie, the total number of shares owned by 'non-controlling shareholders' and 'non-substantial shareholders') at IPO of between 10 and 20 per cent.

If the investor contemplates an exit by way of the sale of shares in a stock exchange in Indonesia (for example, via the Indonesia Stock Exchange (IDX)), this sale would be taxed at a favourable rate (0.1 per cent of the sales proceeds amount (plus 0.5 per cent 'founder' tax)).

The other limitation is a lock-up for the founder meeting certain conditions (see question 16).

In relation to the sale of a portfolio company, private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer via a put option, management seat control and certain conditions for qualifying IPO situations.

The exit also can be structured by IPO at offshore level depending on the commercial consideration and tax treatment.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Generally, other than rights of first refusal, most governance rights and other shareholders' rights and restrictions typically survive an IPO. The public company would be subject to various additional good corporate governance obligations such as ensuring the presence of an independent commissioner and director, audit committee and other committee, corporate secretary, etc.

Post-IPO, OJK regulations require an adjustment towards the newly listed company's articles of association to conform to the requirements under the regulations. The shareholders' agreements may state that its terms will survive post-IPO, however, in the event of conflicting provisions between the articles of association and the shareholders' agreement, Indonesia's courts would generally give credence to the articles rather than the terms of the shareholders' agreement. Thus, in the case of a dispute, the investors' rights under the shareholders' agreement would be enforced under contract law, rather than under the Company Law, and depending upon its governing law, often at a venue outside of Indonesia's court system. These foreign court judgments, however, cannot be enforced directly in Indonesia.

For this reason, the preferred dispute resolution mechanism in a contract involving a foreign investor is to utilise arbitration in an internationally recognised arbitration venue. Singapore is the most prominent venue, and arbitration conducted there would adopt the rules of the Singapore International Arbitration Centre. Another alternative dispute resolution mechanism is the Indonesian National Arbitration Board.

If a foreign investor successfully obtains an arbitral award offshore, enforcement against the Indonesian party requires registration and enforcement of the award through the Indonesian courts. In practice, it is rarely possible to obtain an injunction or other forms of specific performance against an Indonesian party in Indonesia. In general, awards of damages against an Indonesian party is the best outcome one can expect for a breach of contracts action.

Furthermore, a party that acquires shares or other equity securities from issuers with a price, conversion value or executing price below the IPO price during the six months prior to submission of a registration statement to the OJK, is prohibited from transferring some or all ownership of the shares and the other equity securities until eight months after the effectiveness of the registration statement.

An exit is typically done by way of public offering of stock in the local stock market (eg, IDX).

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

There is no particular industry that has been the target of going-private transactions. However, several sectors in Indonesia remain attractive for private equity investment, including IT and internet-based industry, consumer, healthcare, banking and financial services, oil and gas and mining.

Investment in certain industries may require prior approval, licensing or notification.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

The investment structures adopted in cross-border private equity transactions in Indonesia are mostly shaped by the relevant business fields of the target, because of restrictions imposed by the negative list. This causes various structures to be explored, such as synthetic equity or quasi equity before the target goes public, venture capital structure, backdoor listings, mutual funds, back-to-back loans, etc.

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19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

When more than one private equity firm (including strategic partner or other equity co-investor) participates in a club or group deal, the value that each private equity firm can bring to the table and whether such values complement one another must be a consideration of the deal. The value is not limited to the amount of investment but also other contributions such as products or services marketing.

A club arrangement is often contemplated in a master investment or consortium agreement, which provides sharing of costs and returns, exclusivity and decision-making between investors.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

The key issues that arise between a seller and a private equity buyer related to certainty of closing are normally related to valuation, fulfilment of conditions precedent, compromised control sharing and exit strategy. The discussions between the parties throughout all stages of negotiation are essential in agreeing the key terms and in avoiding any of the parties losing face.

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Italy

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Leveraged buyout (LBO) and expansion and replacement transactions represent the majority of private equity investments. To a lesser extent private equity investors sponsor restructuring, venture capital, management buyout and going-private transactions. Equity kicks are also common in mini-bond debt financing, which was introduced in 2014.

Expansion and replacement transactions are the most natural equity financing for restructuring and venture capital transactions. They are also very popular for financing traditional private equity deals during the periods when private equity investors have excess dry powder available or banks are reluctant to provide debt acquisition financing.

LBO transactions are now organised with two-step structures. Investors form a special-purpose vehicle (SPV) with minimal stated capital and legal reserves. The SPV receives equity funds from private equity investors as surplus capital and short-term debt financing from banks. The SPV uses contributions to acquire a target. Thereafter the target company merges into the SPV, with the SPV being the new target company surviving entity, which uses reserves and borrowings under the senior facility to reimburse the short-term financing. Bank revolving facilities are also made available to the new target company for working capital purposes. This structure replaced the three-step structure when amendments to the Italian Civil Code were introduced in 2004 and 2008 to increase legal certainty for LBOs in Italy.

Vendors' loans and rollover financing are also frequently employed in private equity transactions.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Italian corporations are typically organised as companies limited by shares or limited liabilities companies, both being subject to statutory governance rules (to a lesser extent for limited liability companies) that heavily impact private equity transactions: for instance, majority shareholders may be accounted for mismanagement of the target and loans from shareholders are junior to other sources of debt financing.

Governance rules may also be freely contractually agreed. Indeed, in private equity transactions, governance is heavily negotiated, particularly in respect to qualified majorities and veto rights for the adoption of corporate resolutions and share transfer restrictions. Contractually agreed governance rules affecting voting rights may only be entered into for a limited time period (maximum of five and three years, for privately held and listed companies, respectively), unless they are reflected in the by-laws.

Going-private transactions imply several advantages in terms of simplification of the company's structure. Remaining or becoming listed companies exposes such to extensive laws (mainly Legislative Decree No. 58/1998) and regulations from the securities and exchange commission, which provide for disclosure obligations, establishment of ad hoc committees, exposure to mandatory tender offer rules, etc.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

As a general principle applicable to both listed and privately held Italian companies, a director must act in the best interests of the company and its creditors. A director must inform the other directors and the statutory auditors of any conflict of interest; if the conflicted director has executive powers, he or she shall abstain and refer the matter to the board.

When a tender offer is made in connection with a going-private transaction, directors issue a public statement containing all useful information contributing to evaluating the offer and their own assessment on the offer, including regarding the fairness of the price and if such assessment is substantiated by an expert opinion. Directors also disclose whether resolutions in respect of a tender offer were adopted with unanimous consent or, alternatively, the name of the dissenting directors and the reason for their dissent. Also, the statement must indicate whether directors participated in the negotiations of the going-private transaction. Directors immediately inform workers of the existence of an offer and of their assessment on the offer.

Independent directors may play a key role in connection with a going-private transaction, for instance, when one or more directors directly or indirectly promote an offer. In this case, a reasoned assessment on the offer, substantiated by an expert opinion, as the case may be, must be prepared and approved by the independent directors well before the board of directors at large issues the public statement evaluating the offer and its assessment of the offer. Also, independent directors, if they so request, must be informed of any communication made by the issuer to banks providing financing in connection with leveraged going-private transactions.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

There are no specific disclosure rules in connection with going-private transactions.

General disclosure obligations apply to listed issuers (the obligation to disclose to the public any information that may have a material effect on the price; stock option plans for officers and directors, etc), their shareholders (the obligation to inform the securities and exchange commission and the issuer of the holding of qualified participations in excess of 3 per cent or higher thresholds; disclosure of shareholders' agreements regulating the exercise of voting rights, etc) or officers and

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directors (who are under the duty of disclosing their dealings on the shares within five business days).

Pending tender offers, a higher degree of transparency applies to the extent that dealing on shares must be disclosed before the close of day. In case of rumours on the offer, the securities and exchange commission has the right to request the information necessary to inform the public. Confidentiality (and, therefore, delaying disclosures) may be opposed to the securities and exchange commission only if adequately reasoned. Also, under the fairness rules issued by the securities and exchange commission, the issuer has a duty of providing to a competing offeror, if any, the same information provided to the original offeror.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Timing of going-private transactions is strictly regulated by Legislative Decree No. 58/1998 and securities and exchange commission resolution No. 11971 of 14 May 1999.

The offeror must promptly inform the securities and exchange commission and the public (with certain minimum standard information to be complied with) of its intention to submit a voluntary takeover bid (or that the conditions for a mandatory takeover bid are met). The offer document must be submitted to the securities and exchange commission within the following 20 days. In principle, the securities and exchange commission must complete a review and authorise publication of the offer document within 15 days (or suspend the procedure if additional documents and information are required, for a period not exceeding 15 days).

The offer or subscription period starts one to five days from the publication of the offer document (depending on whether the offer document includes the notice issued by the target commenting on the offer). Its duration is usually comprised between 25 and 40 days for voluntary offers (and between 15 and 25 days for mandatory offers) and is agreed with the stock exchange or the securities and exchange commission, depending on whether or not it relates to financial products admitted to trading in a regulated market.

In addition to the foregoing general rules, other specific circumstances may impact on timing, as follows:

- if launched in more jurisdictions, the offer or subscription period may be extended one or more times by the securities and exchange commission by up to 55 days or may follow different time schedules;
- defensive measures may be adopted by the target company consistent with applicable law (mainly if approved by the shareholders' meeting) or the target by-laws;
- the original offer is modified (in such case, the offer must remain open for at least three days);
- competing bids (to be communicated within five days from expiry of the offer or subscription period) and counter offers (within the following five days) are launched;
- where the bidder becomes the holder of 95 per cent or more of the securities of the target company, sell-out or squeeze-out sales may be forced by the remaining shareholders and the bidder, respectively; and
- clearance of the transaction by other authorities, etc.

On the contrary, consistent with international practice, the timing of private equity transactions relating to privately held companies changes on a case-by-case basis, depending on the complexity of the due diligence process, the length of negotiations, the specific structure of the deal (including financing), clearance by competent authorities, etc.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Several options are available to shareholders wishing to express their dissent pending a going-private transaction, both under corporate and public bids rules.

Qualified minorities may convene shareholders' meetings. They may initiate (and agree to settle) lawsuits against directors. Also, more recently, a higher degree of flexibility has become possible when structuring by-laws of public companies, which may contribute in balancing the conflict between majority and minority shareholders, including in connection with public offerings. For instance, special shares may be issued to minority shareholders, who enjoy extra voting rights or special rights for the appointment or termination of directors. However, rights under the special shares may not be enforced in connection with public offers whereby the qualified majority of 75 per cent or more of the capital is obtained at the close of the offer period and a shareholders' meeting is convened to modify the by-laws or to appoint the new directors.

Acquirers wishing to address shareholders' dissent in going-private transactions seek support from large groups of shareholders and customarily condition the transaction to obtaining minimum thresholds as a result of the offer (95 per cent of the capital) and thereafter squeeze out the minority shareholders (if the intention to exercise such right was originally stated in the offer document).

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

No specific representations and warranty provisions apply to private equity transactions on the buy side. Consistent with international practice, private equity investors customarily obtain full title and business representations and warranties from sellers (particularly for majority deals) and heavily negotiate price adjustment mechanisms, particularly accounting principles to establish debt and working capital as of the closing date.

On the sale side, private equity investors usually seek insurance coverage to secure their indemnification obligations (and freely distribute proceeds from the sale of portfolio companies to limited partners or managers). Covenants are more elaborate. Pre-closing covenants include the obligation of the private equity investor to cause the establishment of, and the contribution of equity financing to, the acquisition vehicle and seek short-term financing and irrevocable commitment for post-merger long-term senior financing. Post-closing covenants spell out in detail the parties' obligations in respect of the post-closing merger, in particular the adoption of the relevant corporate resolutions and compliance with certain other Italian Civil Code requirements, including cooperation in describing the financial resources for the transaction, in preparing a merger report on the legal and financial reasons underlying the merger and appointing an expert to deliver an opinion as to the adequacy of the exchange ratio and of the merger report. These post-closing covenants are now seen in share purchase agreements for LBO private equity transactions in spite of a consolidated case law whereby the assets of the target may only qualify as a generic guarantee for the acquisition. Arguably, this is based on the assumption (untested in court) that the 2004 and 2008 reforms of Italian corporate law now expressly regulate the cases of a merger of two companies (whereby the acquiring entity uses debt to acquire the target) and, under certain quantitative and procedural conditions, of a corporation limited by shares offering financing or guarantees for the purchase or subscription of its own shares, respectively.

Closing may or may not be conditional to financing, depending on the negotiation leverage of the private equity investor. If this condition is successfully negotiated by the private equity investor, sellers usually obtain a liquidated damages payment if the transaction does not close.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

Management incentives are a structural part of any private equity transaction and are discussed from the very outset of the negotiations. Private equity transactions in Italy typically focus on businesses where the funder and his or her team played (and are expected to play) a key role. Funders are usually offered a rollover investment (often substantial) in the acquisition vehicle and a casting vote on key governance resolutions. Funders and their team are offered a service agreement

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with the target company, which provides for equity-based incentives vested over a three to five year period, based on agreed-upon performance thresholds of the target or the achievement by the private equity investor of agreed-upon returns. Vesting is accelerated upon exit by the private equity investor or termination of the manager, or both (bad and good leaver provisions regulate economic terms and the duration of the non-compete restriction).

Financial assistance rules do not apply to transactions aiming at facilitating the acquisition of shares by employees, provided that certain quantitative limits (distributable profits and reserves) are met.

Additional arrangements may be evaluated on a case-by-case basis in connection with going-private transactions, depending on existing incentive schemes, which are customarily entered into and adequately disclosed by listed companies pursuant to applicable securities laws.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

In the absence of a sound business purpose, Italian tax authorities have often challenged interest deductions in connection with LBOs. Under a recent release from Italian tax authorities (dated 30 March 2016), based on the acknowledgment that LBO transactions are an established market practice and are specifically regulated by the Italian Civil Code, interest payments made in connection with LBO transactions may be deducted either in the case of a merger or in the case of the election of tax consolidation between the SPV and the target for a percentage of up to 30 per cent of the gross operating margin, subject to the general transfer pricing rules. This general rule applies irrespective of whether shareholders and lenders qualify as Italian-based entities.

Under no circumstances can fees for services rendered by managers in the exclusive interest of the private equity fund or its investors be deducted if charged to the SPV or target. Accordingly, tax authorities will customarily scrutinise fund rules (in particular clauses providing for the total or partial offsetting of management fees against fees charged to the SPV or target) and other fee-sharing arrangements that are not in line with market practice.

By the same token, according to the foregoing recent release of tax authorities, VAT on transaction costs may not be deducted by the SPV, unless commercial activities are actually carried out by the SPV (the mere holding of a participation, without an active involvement in its management, does not per se qualify as a commercial activity subject to VAT).

Taxation of incentive plans is in principle subject to employment income tax at ordinary progressive income tax rates. Since the entry into force of Law Decree No. 112/2008, income from the exercise of stock options schemes (the difference in excess between the strike price and the normal value of shares issued in connection with a stock option plan) also falls under employment income tax (however, it is exempt from social security contributions). Ad hoc stock options may follow different and more favourable tax paths if certain precautionary measures are adopted, including paying consideration for the stock option.

Sellers incorporated under Italian law benefit from a 95 per cent exemption on corporate tax income (IRES) for capital gains arising out of the disposal of shares held in, or dividends received by, Italian or foreign companies. The exemption applies if shares are held – without interruption – for 12 months or more before the sale, are accounted as financial fixed assets in the first financial statements approved after their purchase, and are shares in a company carrying out a commercial activity that does not generate a substantial part of its income in a tax haven jurisdiction or in a jurisdiction with a special tax regime (the latter two requirements must exist for at least three consecutive years before the sale or the life of the company, if less).

The transfer of shares in Italian corporations limited by shares is subject to financial transaction tax (Tobin Tax) of 0.2 per cent (0.1 per cent for listed companies) tax rate on the value of the transaction (certain exemptions apply to intra-group transfers or sales made in connection with a group reorganisation). No VAT applies to transfers of shares, quotas, bonds and other securities.

Gains arising out of sales of corporate assets are subject to IRES (at a 24 per cent rate). VAT or registration tax applies, depending on whether the disposal relates to one or more assets, or assets organised as a going concern, respectively.

Capital gains or losses are generally excluded from regional tax on productive activities (IRAP). Interest costs deduction for IRAP purposes is restricted to financial institutions or holding companies.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Most frequent private equity transactions – traditional mid-market LBOs – are now organised with a two-step structure (see question 1).

In connection with the merger, among other things, directors of the SPV and target must indicate the financial resources that will allow repayment of the acquisition debt, such indication to be substantiated by third-party independent assessment.

Following the 2004 and 2008 reforms of Italian corporate law, the case of a merger of two companies whereby the acquiring entity uses debt to acquire the target, and, under certain quantitative and procedural conditions, a corporation limited by shares is permitted to offer financing or guarantees for the purchase or subscription of its own shares, respectively, is expressly regulated. The merger procedure in connection with an LBO transaction is benefiting from a clear legal framework, and the two-step structure is now market practice, provided that the safe harbour provisions introduced by the 2004 and 2008 reforms are strictly respected.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Under standard private equity transactions, parties heavily negotiate and regulate the financial conditions to closing and the risk allocation between buyer and seller if financial resources fail to materialise between signing and closing.

Under going-private transactions, the securities and exchange commission regulations aim at minimising the uncertainty of funding and require the bidder to make financing arrangements for wholly fulfilling all payment commitments in cash or in kind immediately, in any event before informing the securities and exchange commission and the public of its intention to submit a voluntary takeover bid. Such financing arrangements are typically set out in performance guarantees issued by financial or insurance institutions. In the case of exchange offers, financing arrangements include the adoption of all resolutions necessary for the issuance of the financial products offered in kind as price consideration.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Historically, and up to the year 2000, the Italian Supreme Court closely scrutinised and censured LBOs that ended up with the bankruptcy of the target company. Financial assistance was strictly prohibited under the pre-2008 reform of article 2358 of the Italian Civil Code and was punished with imprisonment of up to three years and fines under article 2630 of the Italian Civil Code.

The reform of Italian corporate law in 2004 (incorporating EEC Directives III and VI) introduced a new provision into the Italian Civil Code, article 2501-bis, which expressly regulates the case of a merger of two companies whereby the acquiring entity uses debt to acquire the target, and provides for a number of safe harbour protections, including that the merger plan clearly shows the financial resources for the reimbursement of the debt (and is substantiated by an independent

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third-party assessment), and the directors of both entities indicate the business reasons underlying the transaction, the financial sources and the objectives of the transaction.

In 2006, the first Supreme Court decision issued after the entry into force of the 2004 reform of Italian corporate law acknowledged that article 2501-bis officially introduced LBOs in the Italian Civil Code and that article 2630 of the Italian Civil Code had been abolished in 2002. It also acknowledged that LBOs may still be relevant from a criminal law perspective and be scrutinised under the fraudulent conveyance principle if the merger is not supported by an adequate industrial project.

The 2008 reform amended article 2358 of the Italian Civil Code and contributed to ensure a safe legal framework for LBOs. A corporation limited by shares may offer financing or guarantees for the purchase or subscription of its own shares, and therefore financial assistance is permitted, provided that certain quantitative limits (distributable profits and reserves) and procedural requirements are met (among other things, directors must describe the business reasons and objectives of the transaction along with the interest for the company and the potential risk and obtain formal approval by the shareholders).

Private and going-private LBOs in Italy must be completed under strict compliance with the safe harbour provisions of amended article 2358 and new article 2501-bis of the Italian Civil Code to minimise the risks of bankruptcy or criminal fines.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

In many circumstances, mostly when private equity firms make minority or majority investments and the original entrepreneur retains control over the day-to-day management, shareholders' arrangements on governance and transfer restrictions are market standard.

Governance arrangements are consistent with international standards and mostly regulate the appointment of directors and other key people (chairperson, CEO, CFO), the powers of executive directors, veto rights on certain reserved matters, deadlock in the case of 50/50 investments, access to periodic financial reports, corporate books and records and inspection rights. Transfer restrictions are also consistent with international standards. Under case law, drag-along rights are enforceable only to the extent that dragged shares are given a value at least equal to the consideration paid to shareholders in cases where they are entitled to withdraw from a company under the Italian Civil Code.

Shareholders' agreements being limited in time (five years for privately held companies), shareholders seek to reflect their arrangements in the by-laws to the maximum extent possible. On the contrary, agreements regulating co-investment or underwriting rights of private equity firms are generally maintained secretly.

Minority shareholders enjoy certain statutory protections (for instance, qualified minority shareholders have the right to challenge shareholders' resolutions (5 per cent of the capital) and to obtain the convening of the shareholders' meeting or the filing of a derivative action for misconducts of the board (10 per cent of the capital)).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Share transfers of privately held companies are typically subject to transfer restrictions set forth under the relevant by-laws or shareholders' agreement (right of first refusal, tag-along, drag-along). Acquiring control may be subject to clearance of competent authorities, such as antitrust (if given turnover thresholds are met) or other regulators (eg, the Bank of Italy and the Institute for the Supervision of Insurance) depending on whether the target operates a regulated activity.

The acquisition of qualified participations (in excess of 3 per cent or higher thresholds) in listed companies is subject to certain disclosure obligations. The acquisition of control is strictly regulated both for voluntary and mandatory takeover bids, particularly the latter bids which must be launched if given thresholds are exceeded (a mandatory bid must be launched if the bidder alone or in concert owns 30 per cent or more of the voting rights; if the bidder owns 95 per cent or more of the voting rights as a result of a bid, sell-out or squeeze-out sales may be forced by the remaining shareholders and the bidder, respectively; also certain free-float re-establishment or mandatory bid rules apply if a shareholder owns 90 per cent or more of the voting rights of a public company).

Update and trends

In the 2017 Italian market, an increasing interest in special purpose acquisition companies (SPACs) has been registered. Nine new SPACs were created in Italy in 2017 (only 11 existed until the end of 2016), with a global value of more than €1.6 billion.

SPACs are investment vehicles structured in the form of a publicly traded company, for the purpose of making one single investment in the form of a buyout acquisition. A SPAC serves as an accelerator instrument for the listing of a target company on the stock exchange. The capital collected during the IPO of the SPAC is kept in escrow until a target company is selected by the sponsors and the investment in such target is approved by a majority of the investors (approximately 90 per cent). Investors that do not approve the investment selected by sponsors are entitled to reimbursement of their investment in the SPAC. After investment in the target, the target is merged into the SPAC and therefore listed on the relevant stock exchange. Dissolution and liquidation of the SPAC take place if a target company is not selected in due time or investment is not approved by the requested majority of investors (generally within a maximum of 24 months from the incorporation of the SPAC). SPACs ensure great flexibility, participation of investors in the final investment decision and high liquidity.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Private equity firms typically eliminate all restrictions (mainly the right of first refusal) to the free sale of their stakes in portfolio companies and obtain drag-along rights in connection with the negotiation of the principal terms of the investment. Conducting an IPO depends on a number of odds, which are difficult to predict at the time of the investment, including approval by the competent corporate bodies and favourable market conditions. To minimise the risk associated with this exit strategy, private equity firms typically successfully negotiate the right to select, appoint and lead the negotiations with the sponsor or global coordinators.

In connection with the sale of portfolio companies, depending on the funds' rules, private equity firms usually structure the transaction in order to maximise distribution of the proceeds from the sale of portfolio companies to the limited partners and managers of the fund. Insurance coverage and other escrow arrangements for liabilities arising out of the typical indemnifications of the seller for misrepresentations or breaches of covenants, as well as reduced representations and warranties in consideration for price discounts are customary, particularly at the end of the investment period of a fund.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Rights and restrictions under by-laws and shareholders' agreements do not necessarily perish if they are not incompatible with an IPO. If shareholders' agreements are maintained in force after an IPO, it is assumed that shareholders bound by such agreements act in concert and therefore mandatory tender offer rules apply if the relevant thresholds are exceeded by the parties bound by a shareholders' agreement.

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Typically, stock exchange regulations provide for mandatory lock-up restrictions: for instance, under certain stock exchange regulations, lock-up restrictions apply to shareholders of companies that have run their activity for less than three fiscal years, or in connection with material disposals of shares that were acquired 12 months prior to the IPO. Lock-up restrictions are also entered into on a voluntary basis and on a limited time period as part of the arrangements between key shareholders, including financial sponsors and top managers, and global coordinators or sponsor. Terms and conditions for private equity funds to dispose of shares in their portfolio companies in connection with IPOs are typically part of the exit strategy, and are negotiated by equity sponsors at the outset of their investment, along with all other governance arrangements.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Mid-market companies, mostly in the high-tech, luxury, energy, media, fashion, communication and transportation industries have been the target of going-private transactions, in particular in the first decade of the 21st century, with a peak in 2008.

In principle, no specific regulatory restrictions apply to private equity sponsors, which benefit from a broad spectrum of investment opportunities in Italy.

However, Bank of Italy regulatory schemes may be opposed to private equity sponsors seeking to gain control over financial institutions. Bank of Italy clearance may be refused, and therefore the closing of the transaction could be at jeopardy, if no adequate evidence is given to the Bank of Italy that, under the new ownership structure, the financial institution would abide by the Bank of Italy sound and prudent management rules. Indeed, lack of a mid-long term investment plan, beyond the typical investment period of a private equity fund, is a factor that the Bank of Italy takes into account when assessing compliance with the sound and prudent management rules. Also, Bank of Italy clearance may be refused under anti-money laundering rules and lack of transparency on the ownership chain may be opposed by the Bank of Italy to those limited partnerships resident in blacklisted jurisdictions seeking to gain control over financial institutions.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Specific foreign investment restrictions may apply to strategic industries (principally safety and national defence). Other than certain tax peculiarities and a certain degree of complexity associated with cross-border transactions in selected industries (financial, insurance, etc), Italy has a friendly legal and business environment for cross-border transactions.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Club and group deals assume heavy governance, transfer restrictions and exit arrangements, which in principle are regulated on a case-by-case basis. More structured schemes have been proposed recently, whereby a manager enters into certain umbrella arrangements with family offices or high net worth individuals, whereby investors are offered a right of first view on selected investments. Consistent with club and group deal industry practice, under these umbrella arrangements, commitments to one or more investments may or may not follow, depending on the investor, which retains the ultimate investment decision.

Under ex-post syndication club and group deals, usually the promoter offers new investors a complete set of representations and warranties in respect of the business and operations of the underlying target.

Particularly in the case where private equity firms team-up with a strategic partner, confidentiality of the target proprietary information must be strictly respected (including for protection of competition).

Finally, in going-private club and group deals, all participants are deemed to act in concert and mandatory tender offer rules trigger accordingly.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

In smaller deals, signing and closing occur simultaneously. In mid-market and larger deals, there is a time lapse between signing and closing because of certain conditions to be satisfied or actions to be undertaken by the parties.

A number of issues arise between signing and closing. The seller typically covenants to carry the business and operations of the target in the ordinary course of business (in the absence of a statutory definition, this obligation must be carefully spelled out in the share purchase agreement). Other actions are undertaken by the parties before the closing. Unlike conditions, which depend on circumstances outwith the parties' control (eg, antitrust clearance), failure to comply with actions before closing exposes the parties to contractual liability.

Private equity buyers are often successful in negotiating that closing be conditional upon no material adverse changes in the business and operations of the target occurring between signing and closing (in this case, sellers usually succeed in pinning down the definition of material adverse change and anchoring it to objective events, such as a pre-defined minimum level of sales). Private equity buyers also obtain a covenant from the seller that the buyer has been duly informed of any material adverse change that occurred up to the closing and known

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by the seller (in the absence, indemnification for misrepresentations or breach of covenants being the exclusive remedy of the buyer following the closing, the buyer would have no enforcement measure following the closing). Conditions may be waived only by the party benefiting from the condition.

If sellers successfully negotiate termination rights (for instance, if minority shareholders fail to waive the right of first refusal) buyers usually obtain liquidated damages payments.

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Japan

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

In Japan, there are several types of private equity fund-related transactions, such as going-private transactions of public companies by private equity funds, private investment in public equity and investment in non-listed companies. Among them, the most popular private equity transactions in Japan are going-private transactions of listed companies, paired with a squeeze-out of the remaining minority shareholders with some of the management of the company participating in the transaction. In addition, as is often the case with a private equity transaction, a private equity fund usually obtains financing through leveraged buyout (LBO) non-recourse loans to make investments with sufficient leverage.

To take a listed company private, a private equity fund may commence a tender offer with the shareholders of a listed company. However, in practice it is generally difficult to satisfy delisting conditions of securities exchanges in Japan with a tender offer, and accordingly private equity funds usually proceed with making the target company a wholly owned subsidiary by undertaking a transaction for squeezing out minority shareholders.

There are several schemes for squeezing out the shareholders of a listed company. For example, one of the simplest ones is a cash merger. Here, the private equity fund establishes a shell company in Japan acquiring shares through a tender offer, the target company merges into the shell company, and the shell company pays cash to the existing shareholders of the listed company as consideration for their shares in the merger. As all of the shareholders of the target company receive cash as consideration, they are squeezed out. However, a cash merger is not a common choice for a private equity fund's squeeze-out transaction because a cash merger forces the target company to realise capital gains and losses of its assets as of the date of the merger unless the shell company established by the private equity fund holds two-thirds or more of the issued and outstanding shares of the target company. Instead, the most common structure used by private equity funds for squeeze-out transactions is a combination of a tender offer and a subsequent minority squeeze-out of the remaining minority shareholders. Before the amendment to the Companies Act in Japan took effect on 1 May 2015, it was quite common to make use of a class of shares (shares subject to call) to squeeze out minority shareholders, however, after such an amendment, it has become a market practice to use a demand for sale of shares (demand for sale of shares), which was newly enacted under the amended Companies Act, when a shareholder holds 90 per cent or more of voting rights, and to use a reverse split of shares in other cases.

Typical procedural steps to squeeze out minority shareholders through a demand for sale of shares are as follows:

- a private equity fund establishes a shell company in Japan;
- the shell company commences a tender offer to acquire shares held by shareholders of the target company;
- if the shell company acquires 90 per cent or more of the shares in a target company, after the settlement of the tender offer, the shell company held by the private equity fund requests that the remaining minority shareholders of the listed target company sell their shares and that the board of directors of the target company approve this request of share sale; and
- after an approval by the board of directors of the target company and other relevant procedures, mandatory sale of the shares in the target company takes place.

If the shell company does not acquire or hold 90 per cent or more of the voting rights in a target company, it is not entitled to squeeze out minority shareholders by this mandatory sale of shares provided under the Companies Act, however, in such cases, it has become common to use a reverse split of shares instead of the above-mentioned demand for sale of shares to squeeze out minority shareholders. To squeeze out minority shareholders using reverse split of shares, the private equity fund has to request that the listed target company hold a shareholders meeting to approve the reverse share split, the ratio of which is intentionally set at a very high level so that all the minority shareholders receive only a fraction of a share as consideration. Such fractional shares cannot actually be issued, but instead the aggregate shares are sold to a third party or can be repurchased by the target company, with court approval, and the cash consideration is proportionately distributed to the minority shareholders who were to receive those fractional shares, which effectively leads to a minority squeeze-out.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Listed companies are subject to disclosure requirements and have to file annual securities reports that disclose company information such as financial information, governance-related information and business-related information. Listed companies are also required to disclose relevant information by filing semi-annual securities reports, quarterly securities reports and extraordinary reports in certain instances. If a target company satisfies some requirements after going private, such disclosure requirements are suspended and the company is not required to file such reports. If a target company remains a listed company after a private equity fund purchases some of its shares, then the target company will continue to be subject to the above disclosure requirements. In addition, the major shareholder of the listed company also has an obligation to disclose some information, including financial information.

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3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

As explained in question 1, a going-private transaction often includes a tender offer. Under the tender offer rules in Japan, in the event that a tender offer is launched, the board of directors of the target company would be required to express its opinion with respect to the tender offer. Directors of the target company must satisfy their fiduciary duties in considering the proposed tender offer and any other transaction related thereto, which is explained by a bidder in its registration statement of the tender offer.

Similarly, when a going-private transaction using a merger or any other corporate reorganisation structure or minority squeeze out, such as a Demand of Sale of Shares, is proposed to the target company, directors of the target company must satisfy their fiduciary duty in determining whether or not to proceed with the proposed transaction.

There is an issue of whether the directors of a target company would be subject to a duty to negotiate as high a price as possible or a duty to negotiate an increase in the price with a potential purchaser. So far, the majority view is that directors would not be subject to the aforementioned duty, although unless a proposed price is fair and reasonable, it is difficult for directors to support the proposed acquisition of shares.

It is quite common in Japan for the management of target companies to participate in private equity fund transactions to purchase all the shares of a listed company. In such a management buyout-type transaction, the directors who participate in the transaction with the private equity fund will face a conflict-of-interest issue. In the case of such a transaction, directors of the target company are at least subject to a duty to take appropriate measures to protect the interests of public shareholders. Under the Companies Act, directors who have special interests with respect to a transaction subject to a board resolution are prohibited from participating in the discussion and resolution at the board of directors meeting. Since the scope of 'special interest' in the statute is construed relatively narrowly, it is often the case in practice that directors who may not have 'special interests' but have personal economic interests aligned with the buyer abstain from deliberation and resolution at such a meeting. In addition, to protect the interests of public shareholders and ensure the fairness of the process, it is common practice to form a special independent committee to verify, among other things, whether negotiations between the buyer and the management of the company were properly conducted, and whether the agreed price is fair and reasonable. However, the members of such special independent committees in Japan are not necessarily independent directors of the company, because many listed companies do not have a sufficient number of independent directors to compose a special committee entirely of independent directors. Therefore, it is common to create an independent special committee that also includes one or more independent statutory auditors or independent experts such as attorneys, accountants or academics.

The role of a special committee in management buyout transactions in Japan varies from transaction to transaction. Some committees work as leaders of the transactions on behalf of the company itself and negotiate with the prospective purchaser themselves. Other committees work only as examiners and check whether, among other things, the price and other terms and negotiations by the management are appropriate.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The level of disclosure required for going-private transactions is not different from that required for other tender offer transactions. In the tender offer documents, the offeror has to disclose a great deal of information, including its reasons for the offered price, the purpose of the tender offer, the cap and threshold of the number of shares to be purchased, and funding information for the transaction. However, in the event of a management buyout transaction, disclosure of additional information is required. For example, in the event that the offeror obtained a valuation report or a fairness opinion with respect to the offer price, then such report or opinion is required to be attached to the tender offer registration statement and is disclosed to the public. However, obtaining such reports is not mandatory.

The tender offer rules also require that in the case of management buyout, the offeror must state the following:

- what measures have been taken for ensuring the fairness of a tender offer price, as well as details of the process discussing and deciding to launch a tender offer; and
- specific measures taken by the company for avoiding a conflict of interest.

Accordingly, it is common in practice to explain in detail, among other things, how the target company sets up a special committee, how the negotiations regarding the price have been developed, what discussions occurred at the special committee about the price and other terms of the proposed transactions, and why the special committee concluded that the proposed transaction is appropriate.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

It usually takes approximately four or five months from the launch of a tender offer until the completion of the squeeze-out of the remaining minority shareholders. In addition, it quite commonly takes a few months for a private equity fund and the target company or its major shareholders to negotiate and reach an agreement before the launch of the tender offer, which means that it usually takes more than six months from the beginning of negotiations until the completion of the transaction. As for a short breakdown of the above schedules, the tender offer rules require the provision of at least 20 business days as a tender offer period, and it usually takes five business days from the end of the tender offer period until settlement, which means that a typical tender offer takes more than a month from the launch of the tender offer until settlement. After settlement, the company must set a record date for the subsequent shareholders' meeting, and call for a shareholders' meeting to squeeze out minority shareholders. It typically takes approximately two months before a shareholders' meeting is held, because there are several procedures required for convening a shareholders' meeting, such as setting a record date, fixing the shareholders who have voting rights at the shareholders' meeting, and sending a notice for the shareholders' meeting. However, if the tender offeror succeeded in purchasing 90 per cent or more of the shares in the target company, the tender offeror may dispense with a shareholders meeting and squeeze out minority shareholders using a demand for sale of shares.

When a private equity fund determines the timing of launching a tender offer, there are two points to note. First, in the event that a potential buyer comes into possession of non-public material information of the target company, unless the target company discloses such information to the public pursuant to a certain determined manner, the potential buyer cannot commence a tender offer under the insider trading rules. It is often the case that after the end of the fiscal year, during the course of accounting closing procedures, some facts will become apparent that will constitute non-public material information, however these facts are not sufficiently clear for the company to be able to make a public announcement in respect of them, in which case the buyer would need to wait until the time when the company is able to make a public announcement with respect to relevant material information. Accordingly, the initiation of tender offers immediately after the end of a fiscal year is usually avoided.

Second, private equity funds usually avoid initiating tender offers between the record date of an annual shareholders' meeting (ie, the final date of a fiscal year for most Japanese companies) and the annual shareholders' meeting, and usually avoid scheduling a tender offer period to include the date of an annual shareholders' meeting. Shareholders holding voting rights at shareholders' meeting may propose an increase of the amount of dividends if the company proposes an agenda of distribution of dividends for the annual shareholders' meeting. Even in the

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event that shareholders approve such an increase in dividends, under the tender offer rules in Japan, an offeror is not generally allowed to decrease a tender offer price owing to an increase in dividends after the launch of the tender offer. Therefore, some buyers do not want to initiate a tender offer from the record date of the shareholders' meeting until the date of the shareholders' meeting.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

As explained in question 1, it is quite common for an acquirer to launch a tender offer and, after the successful completion of the tender offer, to obtain a super majority shareholders' approval of the targeted listed company to squeeze out minority shareholders.

It is quite uncommon in Japan for dissenting shareholders to seek for an injunctive order to suspend a tender offer, as it is practically very difficult to satisfy the requirements applicable to such an action.

Other possible methods for dissenting shareholders to challenge going-private transactions are to bring a damages claim against directors of the targeted listed company; to bring an action to challenge the validity of the shareholders' resolution to enter into a squeeze-out transaction; or to exercise a shareholder's appraisal right and challenge the squeeze-out price.

In the event that shareholders suffer economic loss as a result of a going-private transaction of a listed company, those shareholders may initiate litigation against the directors of the target listed company who assented to the going-private transaction to recover damages for loss arising from any breach of the directors' fiduciary duties. However, directors in general are protected by a business judgment rule in Japan and it is not easy for shareholders to prevail in such litigation against directors. For example, there is a case holding in connection with a management buyout transaction where directors faced an allegation of conflict of interest. The court found that the directors had breached their fiduciary duty, however, the plaintiff had failed to demonstrate causation between the breach and the alleged economic loss, therefore the plaintiff was not entitled to recover damages. This clearly shows that it is not easy for shareholders to recover damages by claiming directors have breached their fiduciary duties.

The most commonly used avenue by dissenting shareholders in going-private transactions in Japan is the exercise of a shareholder appraisal right. For example, the Companies Act provides appraisal rights to a shareholder who opposes a squeeze-out using a reverse share split or a demand for sale of shares. By exercising appraisal rights, dissenting shareholders may require an issuing company to repurchase its shares at a fair value. The law also requires the issuing company to pay interest on the appraisal value of shares at a rate equal to 6 per cent per annum, payable on the period from the date of closing of the going-private transaction in connection with minority squeeze out under a demand for sale of shares or the date of 60 days after the effective date of reverse share split to the date of payment for the relevant shares. Dissenting shareholders who exercise appraisal rights may negotiate the price of the shares to be repurchased by the company, however, if dissenting shareholders and the issuing company fail to reach an agreement, such dissenting shareholders may make a petition to a court to decide the price for the shares to be purchased by the company.

As the said appraisal rights are the most commonly used remedy for dissenting shareholders, an acquirer's protection from dissenting shareholders mainly relates to how they can prove the price the acquirer proposed is fair. As a practical step, it is commonly said that without convincing, legitimate grounds, management should avoid amending financial results and forecasts at a time close to the announcement of a tender offer in a management buyout transaction so that management can avoid the appearance of manipulating the market price to make their tender offer more attractive.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

If there is a shareholder (or shareholders) with a large stake in the target company, it is common that the buyer will enter into a purchase agreement with such shareholder or shareholders. The provisions of such purchase agreements are similar to those used in other agreements for acquiring investment interests. However, when shares are acquired through a tender offer, in light of restrictions under the tender offer rules, various unique features are observed in tender offer purchase agreements. Firstly, unlike in the United States and other jurisdictions around the world where offerors are permitted to condition their obligations to settle a tender offer on their receipt of expected financing proceeds, in Japan the tender offer rules restrict the withdrawal of a tender offer to cases permitted under the law, and the tender offer rules have been widely interpreted as prohibiting a financing-out of tender offers. Accordingly, a tender offeror cannot withdraw a tender offer even if it fails to borrow money from banks for the tender offer. Secondly, the tender offer rules in Japan limit the remedies for breach of representation and warranties made by a shareholder. For example, a tender offeror may not walk away from a tender offer even if the offeror discovers a breach of representations and warranties, unless such a breach falls within a category of events of withdrawal that the tender offer rules specifically provide for. In addition, some argue that the tender offer rules do not allow indemnification by a shareholder of the target company, even if the shareholder gives representations and warranties in an agreement and then breaches them.

In transactions by a private equity fund for an acquisition of shares of a listed company without a tender offer, purchase agreements do not generally differ from purchase agreements used in transactions for the acquisition of investment interests in non-listed target companies, although in such cases sellers tend to refuse wide-ranging representations and warranties, because the target company operates independently from sellers.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

It is quite common for a private equity fund to provide some of the management of the target company and key employees with an opportunity to enter into an equity-based incentive plan, such as an opportunity to acquire a minority stake or stock options or to participate in an employee stock ownership plan in the target company after the closing. However, such equity-based incentive plans should be carefully structured as it is possible for the target company to become ineligible for release from its obligation to file a securities report. In addition, if a private equity fund commits in advance to providing the management of the target company with an opportunity to participate in such an equity-based incentive plan after the closing of the transaction, it means that such management will have the above-mentioned conflict of interest because of their future interest in the company. For this reason, it is often the case that private equity funds make a commitment to provide an incentive plan after minority shareholders are squeezed out.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

One of the major tax issues in relation to minority squeeze-out transactions is a possible capital gains tax on the assets of the target company. As stated in question 1, depending upon the structure of the squeeze-out, it is possible to realise a capital gain on assets held by the target company. However, it is possible to avoid such tax if one utilises the reverse share split structure explained above or a demand for sale of shares newly provided in the amendment of the Companies Act as described in the answer to question 1.

As to the deductibility of interest, interest is deductible even if such interest is for subordinated loans; however, a company issuing

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preferred stock cannot deduct the amount of preferred dividends even if the preferred stock is very close in nature to a subordinated loan.

With respect to tax issues related to executive compensation, golden parachutes are not common in Japan and therefore there is no special tax treatment for such a payment, but if the retirement allowance amount is excessive, then the Tax Code does not allow a company to include such excessive amount in its general expenses. Tax treatment for stock options depends on if the issued stock options are tax-qualified or not. If the stock option is tax-qualified, a tax is imposed only when the shares obtained by exercising the stock options are sold. However, if the stock options are not tax-qualified, the holders of such stock options may be taxed as follows:

- when such options are issued;
- when the holder exercises such stock options; and
- when the shares obtained by exercising the stock options are sold.

In general, share acquisitions cannot be classified as asset acquisitions under the Japanese Tax Code.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

In private equity transactions, the most commonly used types of debt in Japan are LBO loans as syndicated loans, and they are usually made with revolving credit and term loans. The terms and conditions of the existing debt should be carefully checked to see if a transaction made by a private equity fund triggers any provision, such as early redemption in the case of a change of ownership. There is no specific financial assistance rule in connection with a target company's support for others to purchase the shares of the company. However, if a shell company established by a private equity fund holds shares in a target company, until the completion of the squeeze-out of minority shareholders, the target company would be prohibited from providing financial benefits to such shareholder in connection with an exercise of shareholders' rights. In addition if, after the settlement of a tender offer, the offeror holds a majority of the shares in the target company, the granting of any security interest on the assets held by the target company for the LBO lenders is not normally done until after the squeeze-out of minority shareholders, because of the fiduciary duty of the target company directors to the shareholders, including minority shareholders.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

For debt financing such as LBO loans, the following are commonly provided terms:

- mandatory repayment in the event that the target company earns a profit;
- early redemption in the event of default; and
- financial and performance covenants in connection with the business activities of the target company.

In the event that a private equity fund finances through mezzanines such as a preferred stock, the payment structure would be one of the most important terms, and an agreement between creditors and the holders of the preferred stock would also be made.

Where a tender offeror plans to raise funds from a third-party funds provider in the form of a loan or an equity capital contribution, a commitment letter, certifying that the funds provider is prepared to provide an agreed amount of money to the tender offeror, must be executed by the funds provider and attached to the tender offer registration statement unless the funds provider has or will have already injected the relevant cash into the offeror's account before the launch of the tender offer (in which case, the offeror can attach a bank account balance statement). It is common for a private equity fund to negotiate with the loan provider in respect of detailed terms of the definitive loan agreement during the tender offer period and enter into a definitive loan agreement after the tender offer period before the settlement of the tender offer.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

If a shell company established by a private equity fund sources most of the funds used to purchase a target company through a loan and subsequently merges with the target company, then it is possible that such a merger may be detrimental to the existing creditors of the target company. Existing creditors may state their objection to the merger and receive payment or reasonable security if there is a risk of harm to existing creditors owing to such merger. However, even if the target company gets into financial trouble following the merger because of the high leverage, it would be hard for creditors to the pre-merger target company to invalidate the merger.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

The key provisions in shareholders' agreements for private equity transactions are not substantially different from those for other transactions. Namely, it is quite common to place transfer restrictions on the shares in the shareholders' agreements, including rights of first offer or refusal, tag-along rights and drag-along rights, a right to appoint directors, and veto rights.

As statutory legal protection for minority shareholders, the Companies Act requires votes by two-thirds of the voting rights present at the shareholders' meeting in connection with fundamental matters such as mergers, demergers, transfers of a significant part of business and amendments of articles of incorporation, which means that a minority shareholder holding more than one-third of issued shares has a veto right under the Companies Act.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

When a private equity fund purchases shares of a listed company, it must comply with the Japanese tender offer rules. The rules are quite complicated and we cannot provide a full description of the tender offer rules here owing to space limitations. However, we recommend consultation with Japanese counsel regarding this point prior to initiating a transaction.

One of the key points to be aware of is that a mandatory tender offer is triggered upon acquisition of more than one-third of the voting shares in the listed target company. An acquirer cannot purchase more than one-third of the voting shares of a listed target company through a method other than a tender offer or purchase on the market. As a result, even if a major shareholder holding more than one third of the voting shares would like to sell its shares to a private equity fund, the private equity fund has to commence a tender offer and provide other shareholders with the opportunity to tender for the shares.

Another major point to be aware of is the regulation under the tender offer rules for setting a cap. An acquirer may generally set a cap on a tender offer, and if the number of shares tendered in the offer exceeds the cap provided by the offeror, then the tender offeror must purchase the applied shares on a pro rata basis. However, an acquirer cannot set a cap if the acquisition through the tender offer could result in the offeror's shareholding exceeding two-thirds of the voting shares. Even if an acquirer would like to set the cap at, for example, 70 or 80 per cent, such a cap is not allowed, and the acquirer is required to purchase all shares tendered if it sets a cap above the threshold.

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Update and trends

As mentioned in question 1, cash merger has not been a popular choice for going-private transactions because capital gains or losses of the target companies are recognised because of the cash merger. Since October 2017 the tax code has changed, and such capital gains or losses of the target companies are no longer recognised if the largest shareholder owns two-thirds or more of the issued and outstanding shares of the target company. This amendment to the Japanese tax code has provided another possible scheme for going-private transactions, however: as of the beginning of December 2017, no tender offer registration statements after 1 October 2017 mention cash merger as a measure to squeeze out minority shareholders, probably because using a reverse share split or demand for sale of shares has become the market practice for squeezing out minority shareholders. However, as it is common for the acquiring company to merge with the target company after squeezing out the minority shareholders in private equity funds' going-private transactions, and cash mergers could simplify the entire squeeze-out process and the following merger, it is possible that this cash merger may spread as a new market practice, and we need to continue to monitor developments.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

In the event that a private equity fund pursues an IPO exit of portfolio companies purchased through a management buyout transaction, Tokyo Stock Exchange states in its booklet that more detailed scrutiny of such companies should be made than that of other non-management buyout companies. In such cases, the stock exchange will additionally check whether the price offered at the time of the management buyout was fair, whether the purpose of the management buyout was rational and the extent to which the business plan made for the management buyout was achieved.

If the target company is not listed and is wholly owned by a private equity fund (and its related parties), there would be little restriction on a private equity firm's ability to sell its stake in the target company to a third party, except for the lock-up stated in question 16 and restrictions under the articles of incorporation of the target company or a shareholders' agreement, if any.

Private equity funds generally resist providing a long-term post-closing indemnification for breach of representations and warranties or covenants and negotiate hard to limit the period for such an indemnification. There are cases where private equity funds agreed to set up an escrow holding part of a purchase price for a limited period (eg, six months) as a sole recourse that the buyer may have after the closing, but such an arrangement has not yet developed to become 'market practice'. In Japan, it has so far not been common at least for the sale of Japanese companies to use transaction insurance, which allows a buyer to recover its damages owing to a breach of representations and warranties by a seller.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

During the review process made by a stock exchange in Japan, the stock exchange generally requests that an agreement between a shareholder and the target company be terminated at the time of filing an application for listing, because listing rules require a newly listed company to treat every shareholder equally. Accordingly, a major shareholder of a portfolio company, including a private equity fund itself, cannot hold special rights such as board appointment rights or veto rights after the IPO.

Japanese law does not have a concept of registration rights as used in the United States, because in the event that a company completes an IPO and applies for listing of its shares, it is required that the company list all shares in the class subject to the listing as well as any new shares in such class when issued. There are cases where a target company will provide a shareholder with a right to file a registration statement upon the request of the shareholder, but such an agreement would need to be terminated at the time of filing an IPO application as explained above.

As to lock-up restrictions, under the listing rules of the Tokyo Stock Exchange, any existing shareholders who were allotted shares within a one-year period prior to the effective date of an IPO must hold (ie, must not transfer or dispose of) such shares until six months after the effective date of the IPO or one year after the effective date of such allotment of shares, whichever comes later. More importantly, from the perspective of private equity funds, it is common practice in Japan for underwriters of the IPO to require major shareholders of the company to abstain from selling the remaining shares of the company for 180 days after the date of the IPO, when they believe such restriction is necessary in light of market circumstances. After these lock-up periods, shareholders are allowed to sell their shares in the market.

Subject to the above-mentioned lock-up restrictions, following an IPO, all shareholders, not limited to private equity sponsors, may sell their shares in the market. Of course, such sales are subject to market conditions. Shareholders may also choose to sell their shares pursuant to a secondary distribution of securities after the securities registration statement filed by the portfolio company comes into effect. In some cases, major shareholders negotiate with and sell their shares to a purchaser who intends to buy a large portion of the shares; however, note that in Japan such a transfer may be subject to the tender offer rule, as explained in question 14.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Previously, it was sometimes said that private equity funds tended to choose companies in industries with relatively stable cash flows, such as the food or beverage industry, because it is relatively easy to agree with loan providers if the target company expects stable cash inflow. However, for recent going-private transactions, the industries are fairly diverse, and we cannot say that there are many going-private transactions focused on a specific industry. There are not many industry-specific regulations that block private equity fund transactions; however, there are some industry-related laws, such as the Broadcast Act, which may restrict private equity transactions.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Investments by foreign companies in Japanese companies that participate in restricted industries, such as power generation, broadcasting, agriculture, natural resources, nuclear-related industries and transportation, require advanced approval under the Foreign Exchange and Foreign Trade Act. Whether an acquisition of a company by a foreign entity is allowed depends upon various factors such as the nature of business of the target company, what percentage of the shares the purchaser intends to purchase, and the purchaser's plans after the acquisition. There are not many cases publicly discussed regarding whether a foreign entity's specific purchase of shares in a restricted industry will be approved or not. One example of a public case, however, is the Children's Investment Fund's plan to purchase more than 10 per cent of shares in Electric Power Development Co Ltd, which was not approved by the relevant governmental authority.

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19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

In club or group deals, shareholders have to provide for many matters, such as governance structure, board appointment rights, veto rights, dividend policy, pre-emptive rights and restrictions on the sale of shares, including transfer restrictions, rights of first refusal, tag-along rights and drag-along rights. However, these issues do not depend upon whether one or all of the shareholders are a private equity fund or not, and there are no specific considerations for a club or group deal where a private equity fund participates.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

In private equity fund buyer transactions without a tender offer, conditions precedent for closing are likely to be negotiated extensively by the relevant parties. However, sellers and a private equity fund purchaser do not usually negotiate so hard on conditions precedent in transactions where a private equity fund plans to acquire shares through a tender offer because, as mentioned in question 7, the Japanese tender offer rules essentially do not allow the setting of conditions on withdrawing a tender offer that is not provided for by law. There are other mechanisms to assure a closing, such as a termination fee arrangement; however, such an arrangement is not common in Japanese private equity transactions.

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Korea

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity transactions that commonly occur in Korea include the following:

- acquisition of the entire or controlling equity of a listed or private company; and
- acquisition of minority equity in a listed or private company by way of:
  - purchasing already issued shares;
  - subscribing to newly issued shares; or
  - subscribing to mezzanine securities including convertible bonds and bonds with warrants.

Structures commonly used for private equity investments and acquisitions in Korea include the following:

- direct equity investments into investment targets (portfolio companies) by a private equity fund (PEF) established under the provisions of the Financial Investment Services and Capital Markets Act (FSCMA); and
- indirect equity investments into portfolio companies through an investment purpose company (IPC) established by a PEF under the provisions of the FSCMA.

It should be noted that although a PEF established under the FSCMA is prohibited from acquiring debt, an IPC established by a PEF under the FSCMA can incur debt. Accordingly, Korean PEFs can only carry out leveraged buyouts by way of establishing and using an IPC for such purpose.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Most Korean companies are incorporated using the *jusikhoesa* (stock company) form of business organisation. A somewhat smaller number of companies are established using the *yuhanhoesa* (limited company) form of business organisation. Although the Commercial Code recognises a number of other forms of business organisation, such forms are impractical for most purposes and the number of companies established using such forms is negligible. The limited company cannot be listed on the Korea Exchange (KRX) and KOSDAQ exchanges, but the limited company provides a greater degree of freedom in corporate governance matters than is provided by the stock company form. One key advantage for the limited company is the fact that it is not required to have audits by outside auditors and publicly disclose its audit reports. Accordingly, until recently, such features have provided an incentive for some listed companies to go private and convert from the stock company to the limited company form. The relevant law was amended recently, however, with the result that, beginning in 2019, the limited company will no longer be exempt from such requirements.

The Commercial Act, FSCMA and KRX rules impose a number of corporate governance rules on listed companies that are not imposed on non-listed companies, such as the following:

- appointment of independent director;
- restriction against extending financing to affiliates;
- appointment of full-time auditor or establishment of audit committee;
- establishment of a committee for recommending independent director candidates;
- appointment of chief compliance officer;
- restriction on determination of issue price for newly issued shares; and
- filing and disclosure of quarterly reports, includes financial status (also applicable to some non-listed companies, such as companies having more than 500 shareholders and formerly listed companies).

Accordingly, although there may be some advantage to going private under certain circumstances, going-private deals have not been particularly common in Korea. To the best of our knowledge, there have been fewer than 10 going-private deals that have been implemented by Korean PEFs. Perhaps the most important reason for this is that there has been no simple and economical procedure available for going private. Until recently, the only way to go private was to first buy minority shares through a tender offer process to the level required by the KRX as a pre-condition to allow delisting (ie, approximately 90 to 95 per cent of the total issued and outstanding shares). Furthermore, if the controlling shareholder desired to freeze out all minority shareholders, it had to acquire 95 per cent of the total issued and outstanding shares.

Recently, however, comprehensive share-swap transactions have been used by some companies to eliminate minority shareholders. In a comprehensive share swap in Korea, a parent company that desires to convert its subsidiary to a wholly owned subsidiary issues its own shares or gives its treasury shares to shareholders of the subsidiary in exchange for the subsidiary shares. But the Commercial Act allows the parent company to give cash to shareholders of such subsidiary instead of issuing new shares to them or giving them treasury shares. Recently, a few parent companies have used the comprehensive share-swap strategy to eliminate minority shareholders. We are not aware of any instances where the minority shareholders of the relevant subsidiaries have attempted to legally challenge such transactions and the validity of such comprehensive share swaps has not yet been tested in a Korean court. In the event that a Korean court upholds the validity of such comprehensive share swaps, we expect that going-private deals will become more attractive to PEFs.

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3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

In Korea, directors are legally charged with carrying out their role in compliance with a general fiduciary duty regarding the interests of the company managed by them. Such duty includes a 'duty of care as a prudent manager' and a 'duty of loyalty'. In Korean law, a person's 'duty of care as a prudent manager' is essentially a 'reasonable person' standard in a management context, meaning the duty of care that is ordinarily expected from similarly situated managers exercising reasonable prudence in carrying out management responsibilities. Further, in Korean law, the 'duty of loyalty' requires that the directors must, as a matter of priority, impartially conduct the affairs of the company for the profit of the company as a whole, rather than for the special benefit of any specific shareholder or subset of shareholders.

Directors may face significant potential liability-risk issues with respect to actual or perceived violations of their fiduciary duty in connection with certain types of private equity transactions and going-private transactions where possible conflicts of interest may reasonably be expected and the directors can be seen as having particular motivations or incentives to give priority to the interests of a specific subset of shareholders at the expense of the interests of the company, thereby violating their fiduciary duty to the company.

It should be noted that, under Korean law, not only are directors subject to such fiduciary duty, but also any management executives (such as presidents, vice-presidents, chairs, vice-chairs, etc) who are authorised to represent or control the company (or both) regardless of whether such executives serve concurrently as directors who are subject to such obligations.

With regard to special committees, Korean companies rarely establish special committees of independent directors for particular transactions and the effectiveness of such special committees as a safeguard has not been ruled on in Korean court cases.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

No heightened disclosure issues apply specifically to going-private transactions or other private equity transactions. However, there may be disclosure obligations associated with particular types of transactions or procedures incidental to implementing a particular going-private transaction or other private equity transaction.

More specifically, a going-private transaction or other private equity transaction in Korea may be structured to involve one or more types of relevant transactions, including, for example, issuances of new shares, issuances of mezzanine securities, tender offers, mergers, share exchanges, spin-offs and share transfers. Such transactions will by themselves (without regard to whether they are conducted in the context of a going-private process) trigger requirements for advance public disclosure of matters such as the purpose and content of the relevant transaction, the identities of the parties involved and other related information. By way of further example, under relevant legal provisions governing disclosure requirements in relation to transactions involving listed companies:

- disclosures must be made with regard to shareholders who acquire shareholding ratios of 5 per cent or more (with follow-up disclosures to be made for subsequent 1 per cent changes of such shareholding ratios);
- disclosures must be made to disclose attainment of major shareholder status (usually attained by acquiring a 10 per cent or greater shareholding ratio) and each subsequent change in the shareholding ratios held by the major shareholders;
- tender offer statements must be filed in connection with any tender offer;
- disclosures must be made in connection with private offerings of new shares or mezzanine securities; and
- filing of a securities registration statement is generally required with respect to an offering or sale of securities in connection with a merger, share exchange, spin-off or transfer of shares.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Timing considerations for a private equity transaction depend upon a variety of factors, including for example:

- the time needed by the target's board (or controlling shareholders) to evaluate the transaction and any alternatives;
- the time required for the completion of any necessary bank financing syndication arrangements or the placement of relevant debt securities;
- the time required for completion of regulatory review by regulators such as the Fair Trade Commission and, in cases involving financial institutions, the Financial Services Commission and Financial Supervisory Service;
- timing factors related to solicitation of proxies, setting shareholding record dates and compliance with requirements relating to convening necessary shareholder meetings; and
- the time required to establish any required alternative investment vehicles and special purpose vehicles or to complete a restructuring of the target prior to closing.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Under Korean law, the common going-private method is to buy minority shares through tender offers up to the level that will allow delisting under KRX rules (ie, approximately 90 to 95 per cent of total issued and outstanding shares). Furthermore, if the controlling shareholder wants to freeze out all minority shareholders, it has to acquire 95 per cent of total issued and outstanding shares.

Korean law does not explicitly provide for rights of shareholders to dissent in relation to a tender offer process. However, in order for a company to delist itself, the controlling shareholder is required to hold approximately 90 to 95 per cent of the then outstanding shares. In this regard, a dissenting shareholder may effectively manifest passive dissent by not selling its shares to the controlling shareholder.

Korean law also allows a controlling shareholder who has 95 per cent or more of the total issued and outstanding shares to compel minority shareholders to sell their shares. Correspondingly, minority shareholders can compel a controlling shareholder who has 95 per cent or more of the total issued and outstanding shares to buy the minority shareholders' shares. In any such process, the purchase price must first be agreed upon between the controlling shareholder and the minority shareholders. If an agreement cannot be reached, the parties may petition the court to determine the price.

In cases where a comprehensive share swap is implemented to implement a squeeze-out, the minority shareholders may exercise their appraisal rights. In this context also, the purchase price for the shares must first be agreed upon between the company and the shareholders. If they fail to reach such agreement, the purchase price will be determined by the court.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Purchase agreements in private equity transactions do not generally differ in substance and scope from purchase agreements used in various other transactions for the acquisition of investment interests. As with other types of purchase agreements in Korea, purchase agreements for private equity transactions can be varied and customised to reflect the particular objectives of the parties involved. To further clarify, no provisions are specifically required by law or market practice for purchase agreements relating to private equity transactions. Similarly, the scope

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of provisions relating to representations and warranties, conditions precedent to closing, time and manner of payment, future roles (if any) of existing shareholders and management, etc, are generally all subject to negotiation between the parties based on their particular circumstances and objectives.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

The issues relevant to directors, as described in question 3, are equally applicable to this question.

As a brief summary, management participation in going-private transactions in Korea is not prohibited and generally does not trigger any specific procedural requirements (other than abstention from voting by directors in conflict-of-interest situations). However, management participation tends to significantly increase the exposure of participating directors to charges or allegations (from shareholders or other parties who may have standing) that they have breached their fiduciary duties. Concerning the timing of a private equity sponsor's participation in management following the completion of a going-private transaction, no legal restrictions apply as to when a private equity sponsor may begin to participate in the management of the target company.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Capital gains tax

Korean withholding taxes are generally imposed on capital gains of a non-resident when the non-resident sells securities held in a Korean company. The applicable rate is whichever is the lower of 11 per cent of the gross sale proceeds or 22 per cent of the net capital gains (if sufficient documentation of the cost basis is available). The general capital gains tax provisions may be subject to exemption or reduction in relevant circumstances under Korean tax law provisions or any applicable tax treaty provisions, but it is generally the responsibility of the taxpayer to claim such exemption or reduction and provide such documentation and information as may be required as evidence of the taxpayer's eligibility for the relevant exemption or reduction.

Dividends and interest

Unless a tax reduction or exemption is otherwise available under an applicable tax treaty, such as under a tax treaty's anti-double-taxation provisions, any Korea-source income received by a foreign corporation from a Korean corporation is subject to withholding by the Korean corporation in accordance with the withholding rates specified in the relevant Korean tax law provisions, based on the classification of such income. The withholding rate that is generally applied to dividends and interest payments in Korea is 22 per cent (including local surtax). This rate may be subject to reduction if the foreign entity is eligible to claim a reduction under an applicable tax treaty.

With respect to the tax liabilities of Korean corporations, dividends are not recognised as deductible expenses, but interest payments, subject to thin capitalisation restrictions, are generally recognised as deductible expenses.

Securities transaction tax

Sales of Korean securities (ie, securities issued in Korea by a Korean company) are subject to a securities transaction tax, which is imposed at a rate of 0.5 per cent of the gross sale proceeds (or 0.3 per cent in the case of on-exchange transactions). Please note that this is in addition to any applicable capital gains tax imposed on gains derived in the sale of the securities.

In cases where the seller of shares in a Korean company is a non-resident of Korea and the purchaser is a resident of Korea, the purchaser must withhold the share transfer tax amount and remit such amount to the tax authority within two months following the end of the quarter within which the purchase of the shares occurred.

Taxation on PEF

A Korean PEF is generally taxable as an entity separate from its investors. However, the PEF may elect to be treated as a partnership for Korean corporate income tax purposes. In such cases, the PEF is treated as a pass-through entity and earnings received by the PEF's investors are subject to Korean income tax payable by each investor in accordance with the amount received by such investor. More specifically, such earnings when allocated to the PEF's limited partners or members, are treated as dividend income, regardless of the nature of the underlying source of the income.

Deemed acquisition tax (DAT)

Under Korean tax law, a shareholder who acquires more than 50 per cent of a Korean company's shares is subject to DAT. In such instance, the shareholder is deemed to have indirectly acquired the company's assets (such as any land, buildings, rolling stock, etc) and is therefore deemed liable for any asset acquisition taxes that may apply generally to acquisitions of the relevant types of assets.

The DAT is calculated by multiplying the book value of the relevant asset by the applicable tax rate (namely, 2.2 or 2.0 per cent, depending on the asset), and then multiplying this result by the shareholding ratio that the shareholder holds in the Korean company.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Going-private or private equity transactions can include one or more forms of debt, such as senior loans provided by banks (usually in two or three tranches) and mezzanine loans by banks or specialised lenders. Debt instruments in the form of various types of notes and bonds (for example, convertible bonds and bonds with warrants) are also commonly used in structuring going-private and private equity transactions.

In general terms, the nature and degree of existing indebtedness of the target company will, of course, affect the availability and terms of financing that may be required for investment in the target company. Beyond this, the most significant issues relate to accommodating the concerns of existing creditors of the target company and, correspondingly, the ways that existing indebtedness will influence the overall structure adopted for the contemplated investment transactions.

In some cases, private equity transactions will be structured to include arrangements with financial institutions to finance both the investment by the acquirer and the refinancing for the target company. The objective in arranging a combined financing and refinancing package is to avoid difficulties with existing creditors of the target company that may otherwise ensue when restructuring the target, such as reduction in capital of the target or divestiture of the company. Structuring an acquisition to include refinancing of the debt of the target company is often aimed at ensuring that the post-acquisition circumstances will be relatively 'clean' by reducing the overall number and diversity of creditors and, where possible, ensuring that the acquirer and the target company will have a common creditor or group of creditors whose interests will be more closely aligned with each other and overall investment objectives. Such an approach generally ensures greater cooperation and flexibility with the relevant creditors in connection with capital reductions and similar matters.

In practice, acquisition financing obtained by an investor is typically secured by one or a combination of the following: the shares of the target company acquired by the investor; the shares of the investor held by the investor's shareholders; and any other assets of the investor. In connection with such financing, certain restrictions will apply according to the type of institution that is providing the financing.

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It should also be noted that investors in private equity may not use their influence to cause target company assets to be used as collateral to secure the investor's acquisition financing.

Except for certain limited circumstances, PEFs organised under the FSCMA are prohibited from borrowing funds. In those limited circumstances in which borrowing is permitted, such borrowing cannot exceed 10 per cent of the value of the private equity fund's assets. On the other hand, IPCs established by such private equity funds are generally permitted to engage in borrowing and may provide guarantees for debts of portfolio companies or persons related to portfolio companies, provided that the aggregate of such borrowing and guarantees does not exceed 300 per cent of the IPC's equity capital.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

In the case of Korean PEFs, it is generally the case that the PEF itself will be a party to the purchase agreement (executed on the PEF's behalf by the authorised manager), entering into such agreement after the PEF has been duly established. In such cases, the commitment amounts of the PEF's investors will have already been determined and will be specified in the PEF's articles of incorporation. Because the PEF investors assume direct obligations for the PEF's undertakings in the purchase agreement up to their respective commitment amounts, purchase agreements in this context do not usually contain separate equity financing provisions. Furthermore, because borrowing by Korean PEFs is restricted, such purchase agreements also do not typically contain debt-financing provisions.

In cases where a PEF indirectly obtains supplemental debt-financing through an IPC, the IPC will itself be a party to the relevant purchase agreement. In such cases, it is common for the IPC to enter into a purchase agreement for a going-private transaction in circumstances where the terms of the debt-financing have been finalised, but the definitive debt-financing agreement has not yet been formally executed by the parties. In such circumstances, a commitment letter from the third-party lender (ie, the lender to the IPC) that includes the final draft (agreed form) of the debt-financing agreement will be furnished to the seller before execution of the purchase agreement. In contrast to this practice, there are also instances where the purchase agreement will be executed before the debt-financing agreement terms are finalised. In recent years, however, the trend increasingly favours the practice of requiring that the terms of any related debt-financing be substantially finalised at the time that the purchase agreement is executed. .

In cases where foreign private equity funds obtain debt financing from Korean third-party lenders, it is nearly always the case that the relevant definitive debt-financing agreement will be entered into simultaneously with the foreign private equity fund's execution of the definitive purchase agreement.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

No particular problems have been raised in this regard.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements frequently provide for share transfer restrictions, tag-along rights, drag-along rights or veto (or consent) rights. Key provisions often include a right for the acquirer of a minority stake to recommend or nominate a representative for appointment to the board of directors. In terms of investment exit strategies relating to investment in an unlisted company, covenants to implement a listing and IPO are sometimes provided in the relevant agreement. However, the most common strategy is to include put-option rights exercisable against the largest shareholder of the company. In Korea, agreements purporting to give put option rights to a shareholder against the company itself are not recognised and are therefore unenforceable. Redemption rights in respect of redeemable shares are enforceable, however, as long as the company has sufficient distributable profits that can be applied to making such redemptions.

The Commercial Code requires the consent of two thirds of the shares represented by those attending a relevant general shareholders' meeting for approvals of such things as:

- amendment of the articles of incorporation;
- mergers;
- splits;
- comprehensive share swaps;
- comprehensive share transfers;
- transfers of all or any substantial portion of the company's business;
- removals of directors or standing auditors; and
- company dissolution, etc.

Further, certain legal rights (for example, the right to request the convening of general shareholders meetings, the right to request the removal of directors, the right to inspect the financial records of the company, the right to request an audit of the business and financial condition of the company and the right to submit proposals for resolution by the general shareholders of the company, to file a derivative action against directors) are provided by law for the protection of minority shareholders who meet certain statutory minimum shareholding ratio requirements. Such minimum shareholding ratio requirements vary depending on the nature of the right and whether the company is a listed company (generally, the Commercial Code applies much lower minimum shareholding ratios for listed companies).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

A public tender offer process must be carried out in accordance with procedures prescribed in the FSCMA when the contemplated acquisition of shares of a listed company entails certain factors prescribed in the FSCMA (namely, a public tender offer must be carried out in circumstances where the acquirer acquires shares outside of the stock exchange from 10 or more persons during the preceding six months and such acquirer, together with specially related persons, holds 5 per cent or more of the total issued shares of the target company after such acquisition). Otherwise, there are no particularly significant regulatory obstacles that would adversely affect the ability of a private equity firm to acquire control of a public or private company in Korea.

In this regard, it should be noted that, in a relatively limited number of cases, depending on the nature of the target company's business, certain additional restrictions may be imposed with regard to the qualifications required of any entity that becomes or seeks to become the target company's largest shareholder, as well as requiring approval from relevant governmental institutions for shareholding above a specified level. (See discussion concerning strategic industries in question 17.) In such cases, these additional restrictions would not be imposed to disqualify the PEF per se, but rather may apply to prevent the PEF from acquiring the relevant shares owing to the fact that the PEF (as would be the case for numerous other entities) did not meet the qualifications necessary to be the largest shareholder of the relevant target company.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

There are no particular restrictions or regulatory limitations on the ability of a PEF to sell its stake in a portfolio company or conduct an IPO of a portfolio company.

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A Korean PEF and its general member (manager) usually seek to avoid exposure to any long-term indemnification obligations. The main reasons are that usually the articles of incorporation of Korean PEFs have no limited member clawback provisions and that the general member is itself the entity responsible for managing the PEF. Some PEFs avoid indemnification obligations or reduce the period of indemnification obligation exposure by lowering the selling price. Some PEFs put an amount in escrow to cover potential indemnification liability until the indemnification period ends. Traditionally, insurance was generally not used by purchasers who acquire portfolio company shares from PEFs in order to address post-closing recourse issues. More recently, however, there has been a gradual increase in the number of purchasers who obtain indemnification insurance and PEFs agreeing to essentially pay the insurance premiums by way of reducing the sale price to an extent that corresponds to the amount of the insurance premiums.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Ordinarily, a private equity fund will have board appointment rights with respect to a portfolio company. In such cases, the private equity fund may sometimes agree, by way of shareholders' agreement, to give up such board appointment rights following the IPO. This is, however, a matter of market practice and not a legal requirement. In Korea, when a company undertakes an IPO and applies for listing of its shares in connection therewith, it is required to include all of its issued shares of the same class in the listing. Following the IPO, such listed company must apply for the listing of any additional new shares issued by the company of the same class as the previously listed shares from time to time. Accordingly, there is no scope for application in the Korean system of the concept of registration rights in the way that such a concept is used in other jurisdictions.

In terms of lock-up restrictions, the largest shareholder is restricted from selling its shares for a prescribed period (namely, in principle, six months for the securities listed on the Korea Composite Stock Price Index market and in principle, six months for the securities listed on the KOSDAQ market) following an IPO and persons who acquire shares from the largest shareholder (including any person who acquires new shares issued by the company by way of allotment to the third party) during the one-year period preceding the date of the application to the relevant exchange for a preliminary listing assessment are also subject to a lock-up period restriction and are required to place such acquired shares into a custodial account with the Korean Securities Depository for the prescribed lock-up period.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

As the number of going-private transactions in Korea is not particularly extensive, attempting to extrapolate any meaningful trends or conclusions as to the types of companies or industries that are typical targets is not possible at this stage. It may take a number of years before there have been enough such transactions to identify any particular trends.

However, it can be noted that one type of going-private transaction category that may be worthy of attention as a possibly emerging trend involves foreign companies engaged in a particular industry or area of business outside of Korea who seek to establish a substantial business presence in Korea by acquiring a listed Korean company engaged in the same industry or business area, and taking such company private as the foreign company's Korean subsidiary.

In this regard, laws and regulations specifically limit the shareholding ratios that foreign investors may hold in companies in certain strategically important industries, such as telecommunications. Additionally, certain restrictions are imposed under relevant laws and regulations regarding the activities of controlling shareholders and largest shareholders of financial institutions, and regarding certain types of transactions subject to approval from the Financial Services Commission.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Under Korean law, thin capitalisation rules are applicable to transactions involving foreign controlling shareholders. In relevant cases, such rules may affect the structuring and financing of foreign private equity investment in Korea.

Additionally, it should be noted that agreements that require the remittance of funds from or to Korea are subject to applicable reporting requirements under either the Foreign Exchange Transaction Act or the Foreign Investment Promotion Act.

Direct investment by foreign investors in Korean companies pursuant to the Foreign Investment Promotion Act is generally unrestricted, with the exception of a limited number of business categories that are subject to foreign ownership ceilings. Foreign investors desiring to acquire newly issued shares of Korean companies are required to file a report to the Ministry of Trade, Industry and Energy (MOTIE) prior to making the acquisition. (The MOTIE has generally delegated the task of processing and accepting such reports to licensed foreign exchange banks in Korea. In practice, therefore, the relevant report will be filed with an appropriate foreign exchange bank and must be formally accepted by such bank to be recognised as validly filed.)

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19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

If multiple private equity firms participating in a club or group investment in a listed company, the participants in such club or group may be regarded as parties 'acting in concert' and in such case their shareholding ratios are aggregated together for the purpose of determining whether they must file a large-block shareholding report (namely, a reporting requirement triggered by the holding of 5 per cent or more of the issued and outstanding shares of a listed company) pursuant to the relevant provisions of the FSCMA.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Issues related to certainty of closing are covered by the relevant contractual arrangements between a seller and a private equity buyer. Standard condition precedent provisions are typically adopted, such as material accuracy and validity of representations and warranties, legality of contemplated transactions, etc. At present, there are no clearly predominant standard practices or provisions with regard to termination rights and allocations of expenses and costs owing to failure to close. The different approaches adopted often depend on the respective bargaining positions of the parties. Parties that have roughly equal bargaining power tend to include provisions for each party to bear its own expenses and costs. Termination fees per se are not particularly common. However, the parties in some cases do include provisions for 'termination fees' in the form of liquidated damages provisions for certain types of termination events where termination is solely the fault of one party.

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Luxembourg

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Dentons Luxembourg

1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

The most common private equity transactions concerning Luxembourg companies would likely be sales of shares in Luxembourg companies holding operational assets typically located in another jurisdiction.

Private equity houses would typically use Luxembourg non-regulated entities to structure their investments (eg, public or private limited companies or, especially since 2013, special or common limited partnerships), although in some cases, for commercial reasons, they may opt for a Luxembourg regulated entity. In some scenarios, the Luxembourg part of an international structure would be built with the purpose of serving as efficient security package for the financing (eg, the Luxembourg 'flagship' double-Luxco structures).

As regards available options to list companies in Luxembourg, there are two markets, both operated by the Luxembourg Stock Exchange: the EU regulated market, as defined in article 4, section 1, point 14 of Directive 2004/39/EC, being subject to the prospectus, transparency and market abuse legislation and offering European passport for securities, and an exchange-regulated market, being a multilateral trading facility, as defined in article 4, section 1, point 15 of Directive 2004/39/EC, where, among others, the compliance with prospectus and transparency legislation is not required; however, there is also no possibility of European passporting of securities listed thereon.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Luxembourg listed companies are subject to a complex body of rules stemming from various sources, in addition to the general legal framework set in the Luxembourg law of 10 August 1915 on commercial companies, as amended (the Company Law).

In particular, the following Luxembourg laws (in addition to the applicable EU level legislation) are relevant:

- the law of 10 July 2005 implementing Directive 2003/71/EC on the prospectuses for securities (the Prospectus Law);
- the law of 23 December 2016 on the market abuse (the Market Abuse Law);
- the law of 19 May 2006 implementing Directive 2004/25/EC on takeover bids (the Takeover Bid Law);
- the law of 21 July 2012 on squeeze-outs and sell-outs of securities of Luxembourg companies admitted or formerly admitted to trading on a regulated market or which have been the object of a public offer (the Squeeze-out and Sell-out Law);
- the law of 11 January 2008 implementing Directive 2004/109/EC on transparency (the Transparency Law); and
- the law of 24 May 2011 implementing Directive 2007/36/EC on shareholders' rights (the Shareholders' Rights Law).

Furthermore, an important 'soft law' source of corporate governance is the 10 Principles of Corporate Governance of the Luxembourg Stock Exchange (the 10 Principles), based on the existing Luxembourg legislation regarding commercial companies and, in particular, the Company Law. They are applicable to Luxembourg companies listed on the regulated market operated by the Luxembourg Stock Exchange, however, as their authors highlight, given their flexibility they may be useful in defining the framework of conduct for any listed company, whatever its nationality or place of listing. The 10 Principles contain mandatory general principles, which must be complied with without exception, 'comply or explain' recommendations (also mandatory, however, a company may choose to depart from them, subject to explaining why it deems that a particular recommendation is not suited to its specific situation) and guidelines that are indicative and not binding. Among other sources of corporate governance, it is also worth mentioning the circulars and regulations of the Luxembourg financial sector supervisory authority (CSSF) applicable to the listed companies listed on the regulated market and the rules and regulations of the Luxembourg Stock Exchange applicable to the companies listed on both the Luxembourg Stock Exchange and the Euro Multilateral Trading Facility.

One of the results of taking a company private, and often an important motivation to do so, is that the above regulations will not be applicable and the governance (in the broadest sense, including management and reporting) becomes simplified and less costly.

The Company Law was amended by a law dated 10 August 2016, which has, in particular, introduced certain changes relevant to corporate governance, such as, among others, the following:

- the rules on the management committee and chief executive officer in public limited companies;
- certain adjustments to the rules on conflict of interest; and
- extended powers granted to the board of directors with respect to certain operations requiring amendments to the articles of association.

At the same time, a new form of company was also introduced in Luxembourg law, the simplified public limited company, inspired by the same type of company existing under French law. The essential features of this new type of company are its very flexible rules with respect to the management and the taking of decisions by shareholders. According to the new provisions, the articles of association may determine freely the composition and rules of functioning of its corporate bodies. In particular, the articles may provide either for a sole director or a collegiate management body composed of one chairman and other directors. However, the use of this type of company could be limited in practice by its inability to proceed to the public issuance of shares.

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3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

As a general principle applicable to both listed and non-listed Luxembourg companies, each member of the board of directors is under the duty to abide by the Company Law, the articles of association and other applicable legislation, as well as to manage the company as a normally prudent and diligent director.

Directors are in an agency relationship with the company. They shall fulfil all obligations mandated by their position and are liable if they violate their social mandate by improperly managing the company or by performing acts in violation of laws or the articles of association. The same rules on liability apply to members of the management committee or to the chief executive officer of public limited companies. Each director must act bona fide in the best interest of the company. Concerning the company's interest, the directors must consider the company as a whole: the company's interests are not necessarily identical to the shareholders' interests or the creditors' interests. In the case of conflict between these various interests, the interests of the company as a whole and as an entity separate from the shareholders must be given priority. In a recent decision of 23 December 2015 rendered in the framework of a litigation concerning the WIND Hellas group, the Luxembourg District Court has taken a view that in the case of a holding company a 'patrimonial' approach to the corporate interest should prevail (ie, the corporate interest of such company should be identified with the interest of shareholders who wish to realise the return on their investment). However, the court proceedings are still ongoing before the court of higher instance, and it is unsure whether such somewhat 'radical' approach will be shared by the Court of Appeal or by the courts in general in other cases.

In addition, the recent changes to the Company Law have introduced the possibility for the minority shareholders of public limited companies (and the corporate partnerships limited by shares), having at least 10 per cent of the total number of the voting rights at the general meeting, which voted on the discharge to the directors to bring an action on behalf of the company against the directors or members of the management board. This will reinforce the importance for the latter persons to consider the interests of all shareholders and not only those of the majority shareholder(s) controlling the composition of the board or of the particular shareholder who proposed them as his or her candidate to the board.

The above principles must also serve as guidelines for the board of directors in the particular context of taking a Luxembourg company private. More specifically, the Takeover Bid Law requires that the board of directors prepares and issues an opinion on the takeover offer (be it voluntary or obligatory). The opinion must be duly motivated and include its views on the effects of implementation of the bid on all the company's interests, specifically employment, and on the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the company's places of business. If is furthermore required that the board of directors consult with the representatives of the employees and, in their absence, with the employees themselves, prior to the issuance of their opinion.

When implementing the takeover Directive 2004/25/EC, Luxembourg has opted for allowing Luxembourg-listed companies to choose themselves whether or not the board of directors should require consent of the general meeting of shareholders to be able to take 'defensive' actions (other than seeking alternative bids), which may result in the frustration of the bid and in particular before issuing any shares, which may result in a lasting impediment to the offeror's acquiring control of the company. The same approach applies to other 'breakthrough' rules (making ineffective certain share transfer restrictions, voting restrictions and arrangements).

In the case of squeeze-out or buyout operations, which may be initiated pursuant to the provisions of the Squeeze-out and Sell-out Law in a Luxembourg company in which a shareholder (or shareholders acting in concert) attained a threshold of 95 per cent of capital and voting rights, the CSSF, involved in the process of determination of the price, may require the board of directors to take a position on the price proposed by the majority shareholder. It may also require that this position be made public.

In the light of general rules on conflict of interest applicable to Luxembourg public limited companies, if a board member has, directly or indirectly, an opposing interest of a patrimonial nature in a transaction that is on the agenda of a meeting of a board of directors, he or she is obliged to abstain from taking part in deliberation and voting on that particular item. In addition, the conflict of interest must be mentioned in the minutes of the board meeting, and the following general meeting of shareholders must be informed about the existing conflict of interest and the board's decision with respect to such transaction. Further to the recent changes to the Company Law, unless the articles of association provide otherwise, in the case of a conflict of interest where the number of board members required to vote and to deliberate cannot be reached, the board of directors may, unless otherwise provided for in the articles, decide that the decision be deferred to the general meeting of shareholders. Similar rules on deferral of decision to a 'higher' corporate body would apply to members of the management committee, daily managers and to the chief executive officer, as well as, in the relatively rare case of a 'two-tier' management system, to the management board and the supervisory board.

In our view, whether a member of the board of directors appointed upon a proposal by the offeror making a takeover bid has a conflict of interest preventing him or her from participating in decisions of the board of directors to be taken in this respect should be assessed on a case-by-case basis; however, this fact alone should not a priori be sufficient to reach such conclusion (especially considering that each board of directors is under obligation to represent the interests of the company as a whole and not only of the shareholder having proposed his or her candidature). For the Luxembourg companies listed on the Luxembourg Stock Exchange, it should be noted that the 10 Principles recommend that the audit committee, where appointed, be informed of any transaction (representing important value) with an entity in which a director has personal interest. Consulting the audit committee is also recommended in case of uncertainty as to whether a particular operation involves a conflict of interest between a director and the company.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The taking private of a Luxembourg company, which may be carried-out via successful completion of a takeover bid or squeeze-out/buyout of all of the company's shares and subsequent delisting thereof, is necessarily subject to the general publication rules applicable to various stages of these operations. In particular, the decision to make a takeover bid or squeeze-out offer must first be communicated to the CSSF and then to the offeree company and the general public. Subsequently, an offer document (proposed price for the squeeze-out offer) and the position taken by the board of directors in this respect must be published (in the case of squeeze-out pursuant to the Squeeze-out and Sell-out Law the position taken by the board of directors, if requested, will be published if the CSSF so requires) and during the acceptance period in the context of a takeover bid, the offeror is obliged to make weekly public reports on the number of shares for which the offer has been accepted so far. Otherwise the Luxembourg company, the offeror, the concerned management and other persons participating in the takeover bid or squeeze-out/buyout process remain subject to the general rules stemming from the Transparency Law and the Market Abuse Law.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

In the case of a going-private operation implemented by way of a mandatory takeover bid, the process starts as soon as possible after the offeror's shareholding (or offerors, in the case of more than one

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shareholder acting in concert) attains the threshold of 33.3 per cent of the voting rights in the company. In both mandatory or voluntary takeovers the decision to proceed must be made public without delay, however, the CSSF must be informed before such decision is made public. As soon as the bid has been made public, the boards of the offeree company and of the offeror shall inform the representatives of their respective employees or, where there are no such representatives, the employees themselves.

According to the Takeover Bid Law, after publication of the decision to proceed with the takeover bid, the offeror must draw an offer document in due course. The latter must be submitted for review by the CSSF within 10 business days from the date of the above publication and the CSSF has 30 business days to take a decision (more if the CSSF deems the document incomplete and requests complementary information). The offer document is published once the CSSF grants its approval and at that time again the boards of the offeror and the offeree company shall communicate the information to the employees or their representatives.

Luxembourg law requires that the time allowed for the acceptance of a bid be no less than two weeks and no more than 10 weeks from the date of publication of the offer document, however, it is possible to extend the acceptance period beyond this time frame (in any case no longer than six months).

In the case of a voluntary takeover bid, once the period fixed for the acceptance of the offer expires, if the offeree acquired control of the company, the shareholders who have not yet accepted the offer may still do so during a short additional period of 15 days.

In case of a bid addressed to all shareholders with respect to all their shares, during a period of three months after the expiry of the acceptance period, the offeree who disposes of 95 per cent of share capital having voting rights and 95 per cent of all voting rights may proceed to the squeeze-out of the remaining minority shareholders at equitable price.

A regular squeeze-out (as opposed to a squeeze-out following completion of a takeover bid), is also subject to a statutory time frame, in this case set by the provisions of the Squeeze-out and Sell-out Law. Once the majority shareholder controlling 95 per cent of the share capital having voting rights and 95 per cent of all voting rights takes the decision to require the minority shareholders to sell their shares to him or her, he or she is obliged to submit the proposed price, together with the valuation report, to the CSSF. The squeeze-out may be completed fairly quickly if none of the shareholders challenge the proposed price. Otherwise, the process may extend over a period of several months, especially if the CSSF requires a second valuation.

In other private equity transactions, the timing of the acquisition may be influenced by various factors. A typical constraint, however, often reflected in the conditions precedent, would be obtaining necessary clearance from the merger control or antitrust authorities. As an important sector of Luxembourg companies are investment companies holding assets located in other jurisdictions, the filings for necessary authorisation or notifications will typically be made outside of Luxembourg where the operational activity of the group held by a Luxembourg company is located.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Taking a Luxembourg company private depends on the response of the shareholders and is not guaranteed to succeed. The only scenario in which a majority shareholder may have control over the process of taking a company private is where (including as a result of a takeover bid) he or she reaches a threshold of 95 per cent of the share capital having voting rights and 95 per cent of all voting rights, in which case he or she may go ahead with a squeeze-out of the remaining minority shareholders at an equitable price.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

The provisions of purchase agreements that we come across in private equity transactions are fairly similar to those in other types of acquisitions (eg, where multinational groups develop their portfolio by purchasing a new company).

In particular, in the case of a purchase of majority or 100 per cent of shares of a company, the representations and warranties would typically extend not only to the shares and the company acquired, but also to the underlying assets. Indemnities covering more specific risks are also conceivable. However, if a private equity investor is buying a minority stake in a company, it is not uncommon that only a basic set of representations and warranties be given by the seller who, him or herself, is the majority shareholder.

If the seller is a private equity investor, this may have an impact on the type of representations and warranties that he or she is willing to give. Typically, a private equity seller exiting from a business is even more keen than an average seller on reducing the scope of the representations of warranties, as he or she is often under constraint to quickly distribute the proceeds of the sale to his or her investors (rather than withholding them to cover possible warranty claims).

Obtaining the financing by the purchaser seems to be a relatively rare condition precedent. Typically, the sellers would screen the bidders in such a manner to retain those in whom they are confident that they will be in position to secure financing and are willing to make an offer that is not conditional in this respect.

As regards the provisions relating to consideration, in recent years we have seen both price adjustment and locked-box mechanisms.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

As a matter of principle, remuneration of directors of Luxembourg companies (both listed and not) must be approved by the shareholders. Rules applicable to fixing the management's remuneration are usually stricter in listed Luxembourg companies than in private Luxembourg companies. Any remuneration arrangements with the management taking place prior to completion of the going-private transaction would need to be made in line with such rules.

By way of example of the rules applicable to Luxembourg companies listed on the Luxembourg Stock Exchange, the 10 Principles require that a company's remuneration policy be equitable and conform to its long-term interest and recommend that remuneration be structured in a manner that protects the company. The company's remuneration policy should also be recorded in the company's corporate governance charter and any changes thereto made in a transparent manner and reported to the shareholders. The 10 Principles also recommend that a remuneration committee be formed to assist with the determination of the remuneration policy. The global amounts of directors' and executives' remuneration (both direct and indirect and including, in particular, the number of shares held or options that may be exercised (and their conditions)) should be made public.

The recent changes to the Company Law include some new rules in relation to the allocation of free shares to, among others, the directors of Luxembourg public limited companies (and corporate partnerships limited by shares). Such issuance may be decided by the general meeting of shareholders but also by the board of directors, based on the authorisation received from the general meeting of shareholders.

Finally, any form of support from the company for subscription of its own shares (eg, financing acquisition of its shares by directors) remains subject to restrictions on financial assistance and are subject to particular scrutiny in terms of its compliance with the company's corporate interest.

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9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Luxembourg is a well-known and well-established jurisdiction for private equity structuring and for investor pooling. However, Luxembourg itself has no large domestic private equity or mergers and acquisitions market. Consequently, insofar as Luxembourg is concerned, private equity transactions generally encompass acquisitions of target companies established outside Luxembourg whereby the acquisition is structured via Luxembourg regularly taxable companies that are in turn owned (directly or indirectly) by the private equity fund. In most private equity transactions, the acquisitions are structured via a share acquisition whereby a Luxembourg company acquires (directly or indirectly) shares in the target company.

Luxembourg companies used in private equity transactions are subject to Luxembourg income tax at a statutory rate of 27.08 per cent in 2017 and 26.01 per cent in 2018 for companies established in the city of Luxembourg. Furthermore, such companies are subject to Luxembourg net wealth tax (imposed at a rate of 0.5 per cent or a reduced rate of 0.05 per cent for the portion of the net wealth exceeding €500 million) with a floor set at €4,815 for Soparfis, and ranging from €535 to €32,100 for non-Soparfis (minimum net wealth tax). Dividend distributions are in principle subject to Luxembourg dividend withholding tax (15 per cent) unless exempt under domestic tax law or applicable tax treaties, or application of a reduced rate under an applicable tax treaty (as explained below).

From a private equity investment perspective, it is of vital importance that the return on investment is structured tax efficiently and that the investment and financing structure does not result in locked-in liquidities. Consequently, when structuring a private equity investment via a Luxembourg company, it needs to be ensured that the income derived from the target company (eg, dividend income or capital gain income) is not effectively taxable in Luxembourg and that the profits derived by the Luxembourg company can be repatriated to the private equity fund in a tax efficient manner.

In this respect it should be noted that one of the fundamental pillars for Luxembourg's success in being a location of choice in private equity structuring is the existence of the participation exemption. The participation exemption provides for a full income tax exemption in respect of income and capital gains provided the following conditions are met: at the time the income or capital gains is derived, the Luxembourg company has owned (or commits itself to continue to own) for an uninterrupted period of at least 12 months a direct participation of at least 10 per cent (or with an acquisition price of at least €1.2 million for the participation exemption to apply for dividends or €6 million for the participation exemption to apply for capital gains) in the capital of a qualifying subsidiary. A subsidiary is a qualifying subsidiary if it is any of the following:

- an entity covered by article 2 of the EU parent-subsidiary directive;
- a capital company that is a tax resident of Luxembourg and fully subject to Luxembourg corporate income tax; or
- a capital company that is subject to corporate income tax in its country of tax residence which is comparable to Luxembourg corporate income tax(ie, subject to a statutory tax rate of at least 9 per cent in 2018 (9.5 per cent in 2017) imposed on a comparable tax base).

As a result of the transposition of Directives 2014/86/EU and 2015/121/EU and in order to counter situations of double non-taxation arising from the asymmetry in the tax treatment of profit distributions among EU member states, dividends and other profit distributions paid by qualifying subsidiaries to their Luxembourg parent company will no longer be tax exempt to the extent that such distributions are deductible at the level of the subsidiary. In addition, an anti-abuse rule was introduced whereby Luxembourg will not grant the benefit of the EU Parent-Subsidiary Directive to an arrangement or a series of arrangements which, having been put in place for the main purpose (or one of the main purposes) of obtaining a tax advantage that defeats the object or purpose of the Directive, are not genuine having regard to all relevant facts and circumstances. In this respect, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons that reflect economic reality.

Consequently, profits deriving from qualifying participations in EU companies will not be exempt if the profits received by the eligible Luxembourg entity have been deducted from the taxable basis of the member state company that distributes the profit (anti-hybrid instrument measure) or the transaction is characterised as an abuse of law.

Depending on the nature of the investors and their tax position and depending on the investment objective, Luxembourg companies often finance the acquisition of the target companies with a combination of equity (eg, with or without the creation of different classes of shares) and (external or related party) debt so as to achieve a maximum flexibility in respect of the repatriation of earnings or capital invested to the investors.

A Luxembourg company can be funded in compliance with thin capitalisation rules, if it is funded under a debt-equity ratio under which an unrelated party would have funded the company having as sole collateral the assets held by the company. If such ratio cannot be demonstrated by the taxpayer, the Luxembourg tax authorities tend to apply an 85:15 debt-equity ratio in respect of the financing of participations.

Furthermore, in principle Luxembourg does not levy a withholding tax on arm's-length interest, while it in principle imposes a 15 per cent dividend withholding tax on profit distributions made by Luxembourg resident companies, subject to a domestic dividend withholding tax exemption applicable if the following applies:

- the dividend distribution is made to, inter alia, the following:
  - an EU entity qualifying under the EU Parent-Subsidiary Directive; or
  - a company that is resident in an EEA country or a country with which Luxembourg has concluded a tax treaty and which is subject to an income tax in its country of residence, which is comparable to the Luxembourg corporate tax (ie, subject to a statutory tax rate of at least 9 per cent in 2018 (9.5 per cent in 2017) imposed on a comparable tax base); and
- the recipient of such dividend has held or commits itself to continue to hold a direct participation in the Luxembourg company of at least 10 per cent of the share capital (or with an acquisition price of at least €1.2 million) for an uninterrupted period of at least 12 months.

An anti-abuse rule exists whereby Luxembourg will not grant the benefit of the withholding tax exemption to an arrangement or a series of arrangements which, having been put in place for the main purpose (or one of the main purposes) of obtaining a tax advantage that defeats the object or purpose of the EU Parent-Subsidiary Directive, are not genuine having regard to all relevant facts and circumstances. In this respect, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons that reflect economic reality.

In addition, the liquidation (including a partial liquidation) of a Luxembourg company is treated as a capital (gain) transaction for the non-Luxembourg resident shareholder and consequently distributions made after entering into voluntary liquidation or upon partial liquidation are not subject to Luxembourg dividend withholding tax.

In practice, Luxembourg entities are often financed with an appropriate combination of equity and (hybrid) debt so as to achieve maximum profit repatriation flexibility with minimal to no withholding tax to be paid in Luxembourg.

Despite the fact that Luxembourg is a location of choice for structuring private equity investments, often the (senior) management of private equity funds being entitled to carried interest (or similar remuneration packages) reside outside Luxembourg. In view thereof, carried interest (or similar remuneration packages) for such managers is often structured by means of such managers subscribing (often indirectly via a foreign company) to a separate class of shares issued by the Luxembourg company. This specific class of shares would receive profit entitlements in line with the terms of the waterfall negotiated between the private equity fund and the ultimate investors.

Notwithstanding the aforesaid, in an attempt to attract foreign resident private equity managers and stimulate them to change their residence to Luxembourg, in 2013 the Luxembourg government introduced a specific carried interest regime for certain employees of

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alternative investment funds management companies. This regime provides for an effective personal income tax rate of approximately 10 per cent of the carried interest entitlement. However, since the scope of the regime is considered too narrow and since the application of the regime is contingent on several strict conditions, the carried regime is in practice not considered sufficiently beneficial to reach the objective. Consequently, in practice, the carried interest entitlement continues to be structured outside Luxembourg, as indicated above.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Any type of debt can be used including, most typically, issue of ordinary or preferred shares, (subordinated) shareholders' loans, notes, convertible preferred equity certificates, junior/high-yield debt, mezzanine debt and senior debt.

It should be noted that pursuant to the Civil Code the right to compound interest (accruing interest on due interest) is limited to cases where the interest has been due for at least one year and the parties have specifically agreed (after the interest has been due for at least one year) that such interest may be compounded. Such provisions are generally considered to be a point of public policy under Luxembourg law and will therefore apply to any Luxembourg law-governed debt instrument; however, it is rather unlikely that a Luxembourg court would consider them to be a point of international public policy and would set aside the relevant foreign governing law in a foreign debt instrument.

Further to the law dated 10 August 2016 reforming the Company Law, there are currently some legal debates among Luxembourg scholars on the exact scope of Luxembourg legal provisions governing financial assistance. The debate originated from the revised wording of article 168 of the Company Law, which, if construed literally, seems to include private limited companies in the scope of the prohibition of financial assistance. Luxembourg practitioners and scholars agree that this unfortunate wording clearly results from an unintentional omission on the part of the Luxembourg legislator when preparing the final version of the amendment law and that it was never foreseen to extend the restrictions on financial assistance to private limited companies. However, while the text of article 168 remains as it is, any operations in private limited companies that could constitute financial assistance should be considered with much prudence.

However, the Company Law allows public companies limited by shares and partnerships limited by shares to grant financial assistance (ie, directly or indirectly advancing funds, granting loans or providing security for the purpose of acquiring the shares of the company by a third party) subject to the following conditions:

- the advance of the funds or granting of loan must take place under the responsibility of the board of directors of the company at fair market conditions, especially with regard to the interest received by the company and with regard to security provided to the company for the loans and advances referred to above;
- the advance of the funds or granting of loan must be submitted to the general shareholders' meeting of the company for prior approval, using the same quorum and majority requirements as for an amendment to the articles of association; and
- the board of directors of the company must prepare a written report to the general shareholders' meeting, indicating the reasons for the transaction, the interest of the company in entering into the transaction, the conditions on which the transaction is entered into, the risks involved in the transaction for the liquidity and solvency of the company and the price at which the third party is to acquire the shares. Those restrictions do not apply to transactions entered into with banks and other financial institutions in the normal course of business nor to transactions entered into with a view to the acquisition of shares by or for the staff of the company or a company related to the latter by a controlling relationship (however, this is always subject to the fact that the company has sufficient net assets).

The amount of the funds advanced or loan made must not result in reducing the net assets of the company below the amount of the profits at the end of the last financial year plus any profits carried forward and any amounts drawn from reserves, which are available for the purpose, less any losses carried forward and any sums to be placed in reserve pursuant to the requirements of the law or of the articles of incorporation. The company shall also include, among the liabilities in its balance sheet, a reserve unavailable for distribution, of an amount corresponding to the amount of the aggregate financial assistance.

A transaction that does not fulfil the requirements of financial assistance may be declared null and void, the directors of the target may face civil and criminal liability and third parties may face civil liability.

In relation to the security, under Luxembourg law a security is accessory to the debt it secures; therefore, it is usual to find contractual provisions creating a parallel debt or an active solidarity in favour of the security agent to grant the security agent the capacity of creditor (and pledgee). If the provisions of parallel debt or active solidarity provisions are still used for security such as mortgages over real estate in Luxembourg, they are no longer necessary in presence of a financial collateral arrangement governed by the law dated 5 August 2005, as amended (the 'Collateral Law', which applies to pledges, transfer of property as security, repurchase agreements and set-off provisions over financial instruments and receivables), since the Collateral Law expressly recognises the role of the security agent.

Although it is not a requirement under Luxembourg law, it is market practice to include a limitation language to an upstream or cross-stream guarantee granted by a Luxembourg company, as it is considered that such guarantee is not necessarily in the corporate interest of the guarantor (downstream guarantees granted to the benefit of direct or indirect subsidiaries are not limited as such guarantees are supposed to be in the corporate interest of the guarantor).

The purpose of a limitation language is to limit as much as possible the risk of directors' and de facto or de jure directors' personal liability; in this sense, the limitation language seeks to avoid that the guarantor faces bankruptcy proceedings as soon as the guarantee is called (the mere act of entering into the guarantee could potentially be considered a director's negligence since, in most of the cases, the call of the guarantee could automatically trigger an insolvent situation).

The limitation language will therefore limit the guarantee to a certain percentage (usually around 90–95 per cent) of the funds available to the guarantor; usually, 'available funds' include equity (ie, share capital, share premium, reserves and profit brought forward, if any) and intra-group indebtedness (such amounts are considered subordinated debt and quasi-equity).

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

For more information on the usual provisions, see question 10.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

The bankruptcy rules in the Commercial Code (articles 445 to 448) provide for the events when a contract, act or payment shall be or may be declared null and void; for example, a contract concluded during the clawback period (which can extend to 10 days and six months before the cessation of payments is declared) will be null and void if the value of what was granted by the bankrupt notably exceeds the value of what the bankrupt has received in exchange. Also, acts made to defraud creditors of the bankrupt are null and void, regardless of the date on which they were passed.

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13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Indeed, rules on transfer restrictions would typically be included in a shareholders' agreement relating to a Luxembourg company. Luxembourg practice is in line with the international standards in this respect and Luxembourg shareholders' agreements often contain a usual set of rules on share transfers such as the right of first purchase, the right of first refusal, the tag-along and drag-along rights. How far the restrictions may go depends on the parties' will, but also, of course, on the legal framework. In this respect, it should be borne in mind that as matter of legal principle, shares in public limited companies and corporate partnerships limited by shares are negotiable and the shareholder may not be completely prevented from transferring them. Lock-up provisions (if limited to a reasonable time period) and transfer restrictions are admissible in these types of companies, however, they may never result in the shareholder becoming 'prisoner' of his or her own shares.

The new provisions introduced recently to the Company Law have expressly recognised the possibility for the articles of association of public limited liability companies to contain lock-up provisions (if limited in time), consent and pre-emption clauses (if the application of such provisions does not lead to a non-transferability being superior to 12 months). Any transfer done in breach of the rules on transfer of shares included in the articles of association shall be null and void.

In private limited companies, until August 2016, share transfer restrictions could go further and even a full lock-up was conceivable (except for some mandatory rules regarding transfer of shares in the event of death). While the private limited company remains relatively closed (in the sense that the transfer of shares or of the profit shares having the right to vote to non-shareholders requires consent of the shareholders representing certain percentages of shares in issue), the recent changes to the Company Law introduced a new legal exit procedure in order to ensure that a transfer of shares cannot be blocked for an undetermined period of time. In this respect, if the company's shareholders have refused to give consent to a proposed transfer to a non-shareholder, they may within three months from such refusal, acquire or have the shares acquired by third parties, or the company may, with the consent of the transferring shareholder, decide, within the same period, to reduce its share capital in the amount of the nominal value of the shares of the transferor and to repurchase these shares. The conditions and manner to determine the sale price of the shares shall be determined by the articles of association. In case of disagreement of the parties as to the sale price (in particular if there are no rules on this subject in the articles of association), it shall be determined by the competent court. If none of the above solutions were applied during the period fixed by the Company Law, the transferring shareholder may complete the initially envisaged transfer without restrictions. Given that the Company Law provides that any provisions contrary to the above rules on transfers of shares shall be deemed non-existent, there have been certain doubts regarding the possibility of providing for a full lock-up in a private limited company (during a certain time). Although, to date (to our knowledge) there is not any case law that would address this particular question, certain Luxembourg practitioners and legal scholars have expressed the view in favour of admitting lock-up provisions (such position was also expressed by the Luxembourg Bar Association in the framework on the consultation process prior to adopting the law of 10 August 2016 amending the Company Law), in which case the rules on the consent for the transfer of shares and the legal exit procedure would apply after the expiry of such lock-up period.

Minority shareholders would not necessarily be granted the right to propose their own candidate for the appointment on the board of directors. In Luxembourg companies, a simple majority (in the case of private limited liability companies, a majority of the share capital) is sufficient to appoint all members of the board of directors and, hence, in the absence of particular arrangements between the shareholders in this respect, it is not necessary to involve the representatives of the minority shareholders in the management.

However, in our practice, we have come across situations where minority shareholders, in particular those having achieved certain thresholds of participation in the share capital (eg, 20 per cent) were granted the right to designate candidates for the appointment as members of the board of directors. We are also aware of cases (in particular of certain start-ups) where strategic investors who provided funding are taking minority interests in the share capital, but at the same time obtain rights to nominate certain members of the board of directors (or, if they do not wish to do so, their observers), as well as consent and veto rights.

Sometimes, the shareholders' agreement may provide for additional consultation or consent rights of the shareholders. In such case, it should always be ascertained that such 'co-decision' rights given to the shareholders are not excessive and do not interfere with the independent management of the company by its board of directors, management board or managers, as the case may be, in which case the shareholders could be deemed effectively involved in the management of the company and incur liability as de facto directors.

Otherwise, the shareholders' influence on the management of the company would, in principle, be indirect (ie, by way of appointing members of the board of directors).

Please also note that, as indicated in question 3, the minority shareholders of public limited companies (and the corporate partnerships limited by shares), having at least 10 per cent of the total number of the voting rights at the general meeting that voted on the discharge to the directors for the performance of their duties, now have the possibility to bring an action on behalf of the company against the directors or members of the management board.

Shareholders' agreements may also include rules on distributions to shareholders, in particular, 'waterfall provisions'. These provisions would normally be included in the articles of association at the same time, considering that rights attached to shares should be set out therein. While it appears possible for the shareholders to agree in a shareholders' agreement on rules of allocation of profits different from those set out in the articles of association, it should always be ensured that application of such rules does not expose the management to liability for the breach of the articles of association.

Among other provisions typically represented in the shareholders' agreement, one may mention, in particular, pre-emption rights (preferential subscription rights – in public limited companies and corporate partnerships limited by shares, such rights result from the mandatory provisions of the Company Law), information rights, rules on confidentiality, on third-party funding, rules on non-competition and non-solicitation. Some shareholders' agreements also contain rules applicable in a situation of a deadlock between the shareholders or board members. In this respect, it may be noted that recourse to the 'buy or sell' or 'shotgun' clauses seems to be rare.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Typical consideration for investors acquiring shares in a listed company is to monitor its shareholding to make sure that it is not forced to make a takeover bid. In Luxembourg, a shareholder becomes obliged to launch a mandatory takeover bid when it attains the threshold of 33.3 per cent of voting rights of the company. Furthermore, a shareholder holding 95 per cent of the share capital having voting rights and 95 per cent of all voting rights may be required by minority shareholders to purchase its stake at an equitable price (the sell-out, or reverse squeeze-out, being a mirror image of the squeeze-out entitlement of the majority shareholders themselves).

There are no particular restrictions on the type of person who may become a shareholder in a Luxembourg company. A limited liability company has a maximum number of shareholders (no more than 100 – this limit was increased from 40), however, a situation where such company would attain this threshold and effectively bar new shareholders from joining is purely hypothetical and never seen in practice. See question 13 regarding lock-up provisions.

There are also certain limitations and requirements applicable to shareholders of certain companies exercising regulated activity.

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Update and trends

Taxation
Luxembourg enacted a reduction of the corporate income tax rate by the law of 23 December 2016, which will enter into force in 2018 with a rate of 18 per cent. The combined corporate tax rate in the city of Luxembourg will thus drop from 27.08 per cent in 2017 to 26.01 per cent as of 2018.

EU Directive 2016/1164 of 12 July 2016, laying down rules against tax-avoidance practices that directly affect the functioning of the internal market (ATAD), and Directive 2017/952 of 27 May 2017, amending ATAD as regards hybrid mismatches with third countries (ATAD 2), tackle hybrid instruments, interest deduction and double tax-treaty abuse. No bill of law implementing these directives has been filed in Luxembourg yet, but their transposition should take place with effect as of 2019 and 2020.

Finally, on 7 June 2017 Luxembourg signed the multilateral instrument (MLI) to implement tax treaty-related measures to prevent base erosion and profit shifting. However, the provisions of the MLI should not come into force before 1 January 2019 for Luxembourg.

Corporate law
As regards corporate law, in 2017 we have seen an increased amount of acquisition, co-investment and joint venture transactions.

Throughout 2017, practitioners started to put into practice various new provisions introduced into the Company Law by the amendment law of 10 August 2016, including, in particular, the amended rules on transfer restrictions in public and private limited companies.

One of the most interesting changes brought by this legislation was the introduction of the simplified public limited company. However, for the time being, the use of this form of company remains significantly below the use of public or private limited companies in terms of the number of newly created companies.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Where more than one investor owns a Luxembourg company, a shareholders' agreement (if entered into) or special provisions of the articles of association would often require that the disposal of the company, including by way of an IPO, be decided only with the consent of minority shareholders (at least those representing a relatively important percentage of the share capital). In such a situation, successful completion of an IPO will depend on the will of minority shareholders to cooperate. Also, a company being party to a credit facility with a bank or other financing institution will likely require its consent, and possibly prior repayment of its indebtedness and release of security on the company's shares.

As mentioned, a private equity firm will often endeavour to structure the exit and, in particular, the representations and warranties and indemnities given in the sale agreement in such a manner that the proceeds of the sale may be upstreamed to the investors as soon as possible. Nonetheless, even the most basic representations and warranties bear with them a risk of contingent liability and, where the disposed investment was held via a Luxembourg company, the directors of the seller company would be well advised to make careful analysis of the potential risks and leave some amount on its account, take out insurance policy or at least enter into indemnity arrangements with the shareholders, to make sure that there is sufficient coverage should any claims materialise. Failing to do so could result in the bankruptcy of the seller, give grounds to liability claims against the directors and in such case even to reopening the liquidation process of a company that was wound up.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

It is common in Luxembourg law governed shareholders' agreements to provide that they terminate automatically upon the company's IPO or commencement of the IPO process. It is not unusual for the parties to a shareholders' agreement thus expired to conclude a short form of shareholders' agreement typically including lock-up provisions (180 days seems to be a standard period) or, for example, provisions requiring some form of consultation and cooperation when selling out the remaining shares in the company post-IPO.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

The most recent information published on the site of the Luxembourg Stock Exchange refers to 20 companies (three domestic and 17 foreign) delisted from the Luxembourg Stock Exchange in 2012 and 17 (three domestic and 14 foreign) in 2011. However, in the absence of further details, we are not able to determine if the delistings were carried out in a private equity or other context.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There are no restrictions on foreign investments. For further information on issues regarding the financing of a cross-border transaction, see question 10.

From a Luxembourg tax point of view, the main point of attention from a deal structuring perspective is to ensure that the investment structure caters for tax efficiency (at the level of the target company and at the level of the Luxembourg investment company) and for sufficient flexibility for profit repatriations to the investors. For these reasons, private equity investments structured via Luxembourg investment platforms are often financed through a combination of equity (eg, with or without different classes of shares) and debt (see question 9).

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

In the situation of a club deal, often the control over the investment will remain with one of the private-equity partners. A vehicle which, at least from the Luxembourg corporate law point of view, may be well adapted for such type of co-investment would be a partnership. Three types of partnership are available under Luxembourg law: a corporate partnership limited by shares, being a corporate entity, subject, to a large extent, to rules applicable to public limited companies; a common limited partnership, being a traditional limited partnership that has been reworked in 2013 into a very flexible form of partnership having legal personality; and a special limited partnership, being a completely new partnership subject to essentially the same rules as the common limited partnership, but without legal personality (however, the law provides that any property or assets of the special limited partnership will be registered directly in its own name).

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20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

While there are sale transactions in which signing and completion take place simultaneously, signing a sale agreement, subject to fulfilment of conditions precedent is, in our practice, more common. These may relate to various topics, such as, for example, obtaining necessary regulatory authorisations, completing restructuring of the target group or settling an ongoing litigation. Material adverse effect clauses are avoided as much as possible by the sellers as a source of additional uncertainty of the closing.

As regards termination rights, the sale agreement may provide that in the event of absence of completion the party other than the one who did not produce its closing deliveries may choose to complete partially, postpone closing or terminate the agreement (often having the right to recover at least some of the transaction costs from the defaulting party).

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Nigeria

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity (PE) transactions in Nigeria can generally be classified into venture capital, growth capital, buyouts (including management buyouts) and mezzanine financing. Available structures commonly used for private equity investments are equity investments and quasi-equity investments, which would include taking preferred stock or convertible notes by the private equity fund entity.

Limited liability companies and limited partnerships are most typically used as investment vehicles for PE investments.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

There are no special corporate governance rules applicable to private equity transactions other than those imposed by sector-specific regulators such as the Code of Corporate Governance for the Telecommunications Industry 2016 issued by the Nigerian Communications Commission. Corporate governance issues relating to private companies in Nigeria, including companies with private equity participation, are generally addressed by contractual agreements, memorandum and articles of association subject to the Companies and Allied Matters Act (CAMA) and any code of corporate governance rules adopted by the company.

The Securities and Exchange Commission (SEC) rules and regulations are applicable to public companies and these rules make substantial provisions for disclosure and reporting requirements. In addition, there are regulatory and disclosure requirements if a public company is listed, as such companies are also subject to the Listing Requirements of the Nigerian Stock Exchange (NSE).

There are obvious advantages when a public or listed company goes private as this will mean less regulation and disclosure obligations. However, it should be noted that it is not a common practice to have companies going private as a result of private equity investments whether in a leveraged buyout or any other transaction.

Where a target company with private equity participation remains a public company, nothing changes. However, where a private company becomes a public company, such company would become subject to the application of the SEC Rules and Listing Requirements of the NSE.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

One major issue that may be faced by the board of directors of a public company entering into a PE transaction is that of ensuring that each of the directors of the company carry out the fiduciary duties as prescribed by CAMA. The fiduciary duties of the directors include a duty to act in good faith, exercise independent judgment, act in the best interest of the company as a whole – so as to protect its assets and promote its business – and avoid conflict of interest, thus mandating that directors declare any interest in any proposed transaction or arrangement.

Conflicts of interest may arise where a director has a personal interest in the private equity transaction. This director is obliged to disclose any such conflict or potential conflict of interest. In addition to the requirements of CAMA on disclosure of conflicts of interest by directors, companies generally have provisions in their articles of association or another document dealing with issues of conflict of interests regarding the board, management and other personnel of the company. This situation needs to be handled properly by the board to avoid the exploitation of any information or opportunity of the company. A special committee of the board, which may consist of independent non-conflicted directors, may be constituted for this purpose. The special committee may be charged to objectively evaluate, review and approve the private equity transaction on behalf of the company.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Under the SEC Rules, the provisions guiding the operation of private equity funds in Nigeria provide for submission of quarterly returns, annual report of the fund to the SEC and semi-annual reports to its investors.

A company to which a takeover bid has been made is required to provide sufficient time and information to all its shareholders to enable them to reach a properly informed decision in respect of the bid. Such disclosures are required to be prepared with the highest standard of care and accuracy and must contain all information relevant to the transaction. Further, listed companies are required to ensure that investors and the public are kept fully informed of all factors that may affect their interest and to make immediate disclosures of any information that may have material effect on market activity in, and the prices or value of, listed securities as well as details of any major changes in the business or other circumstances of the company to shareholders and the NSE. The NSE requires all listed companies to maintain publicly accessible websites whereon companies are required to display conspicuously, information submitted to the NSE.

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The Listing Requirements of the NSE stipulate, among other things, that in order for a public company to voluntarily delist its securities from the NSE, the prior approval of the shareholders must have been obtained by way of a special resolution passed at a duly convened meeting of the company. The company must have given its shareholders at least three months' notice of the proposed withdrawal of the listing including the details of how to transfer the securities. The public company going private must also give the shareholders who so elect, an exit opportunity before the shares are delisted.

SEC Rules mandate a public company seeking to delist to notify the SEC of its intention to delist. The NSE is also required to consider and dispose of the application within 10 days and notify the SEC when it is approved.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Timing considerations for private equity transactions include the time within which proper due diligence exercises can be concluded, the length of time required for the formation or structuring of the vehicle to be used for the execution of the transaction and the exit time projections. Sector specific regulations and approvals also form part of key timing considerations of private equity transactions.

With respect to going-private transactions, a company seeking to voluntarily delist from the NSE is required by the Listing Requirements to have been listed on the NSE for a minimum of three years prior to when it seeks to delist. Consequently, private equity investors seeking to go into a private equity transaction with a public company that has been listed on the NSE for less than three years will have to factor in this timing requirement with respect to voluntary delisting. The SEC Rules require the NSE to consider and dispose of applications to delist within 10 days.

Where a private equity transaction involves a takeover, the offeror is required by the Investments and Securities Act (ISA) and the SEC Rules to seek the approval of the SEC as well as register the proposed bid with the SEC prior to making a takeover bid. Where the approval is granted, the offeror is required to make the approved bid within a period of three months following the date of approval. The offeror may thereafter apply for an extension of this period before the expiry of the three-month period. Where a takeover bid is made for all the shares of a class in an offeree company, the offeror is proscribed from taking up shares deposited pursuant to the bid until 10 days after the date of the takeover bid. Where the bid is made for less than all the shares in a class of the offeree company, the offeror is proscribed from taking up shares deposited pursuant to the bid until 21 days after the date of the takeover bid. A takeover bid is required when the shares being acquired are not less than 30 per cent of the shares of the company.

Further, delays caused by addressing issues such as the rights of dissenting shareholders may form part of the timing considerations in private equity transactions.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Shareholders who do not accept the terms of a going-private transaction may vote against it at the general meeting of the company at which the issue is considered or may choose not to accept a takeover offer. However, where a takeover offer is accepted by the shareholders of a company holding not less than 90 per cent of the shares of the company or the class of shares in respect of which the bid is made, the dissenting minority shareholders' shares may be bought by the offeror at the same price as the other shares or at fair market value after notifying the dissenting shareholders of its intention to do so.

Shareholders, personal representatives of deceased shareholders and persons to whom shares have been transferred or transmitted by operation of law who dissent or wish to object to a going-private transaction can make an application to court to restrain the company from going private on the ground that such an act would affect the individual right of the shareholder as a member of the company.

Further, shareholders, personal representatives of deceased shareholders, persons to whom shares have been transferred or transmitted by operation of law, directors, officers, former directors, former officers and creditors of the company, as well as the Corporate Affairs Commission (CAC), are empowered to apply to court to object to a going-private transaction. Such an application may be sustained only where it can be shown that proceeding with the transaction is:

- illegal, oppressive, unfairly prejudicial or in disregard of interests of a member or members in the case of an application by a shareholder, personal representative of a deceased shareholder and persons to whom shares have been transferred or transmitted by operation of law;
- oppressive, unfairly prejudicial or discriminatory to such director, officer, former director, former officer or creditor of the company; or
- oppressive, unfairly prejudicial or discriminatory against a member or members in a manner that is in disregard of public interest in the case of an application by the CAC.

To deal with any issues that may arise from shareholders' dissent to going-private transactions, acquirers are careful to comply with the relevant provisions of the law and regulations to avoid creating possible grounds upon which the dissent may subsist.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

As with other transactions, the provisions of purchase agreements will depend on negotiations between the parties. Provisions on issues such as warranties, default, anti-dilution, redemption or conversion of preferred equity, composition and powers of the board and management of the company, matters exclusively reserved for shareholders' decision, finance and accounting regime, non-compete, confidentiality and disclosures, tag-along and drag-along rights, exit options and corporate governance obligations are often prominently featured in purchase agreements for private equity transactions.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

One of the concerns of private equity investors includes ensuring that the interests of management align with the interests of the investors with a view to the growth of the company. To this end, management of the offeree company may be required to execute employment agreements with non-compete and confidentiality provisions. Further, the terms of employment of management may constitute part of the pre-closing covenants in a going-private transaction such that management participation and compensation issues are dealt with prior to the completion of the transaction.

Timing considerations for the participation of management in a going-private transaction are often a product of the provisions of the purchase agreement entered in respect of the transaction.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The tax issues involved in a PE transaction depend on the structure of the transaction. Where a PE vehicle is registered as a partnership, the individual partners will be liable to pay tax on their personal income. Limited liability companies, on the other hand, bear the tax as an entity while the individual investors (which could be corporate or individual)

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are liable to tax on their investment income. Income such as dividends, interest and management fees are subject to withholding tax. For non-resident investors, such taxes withheld are treated as their final tax obligation. The target and investors will also need to note that stamp duties may arise at a flat rate or ad valorem on the transaction documents. Other investor tax liabilities will depend on the exit model the PE transaction adopts. For instance, management fees will incur withholding tax while carried interest will incur capital gains tax. Note also that interest on foreign loans that have a repayment period (including moratorium) of two years and above enjoy certain tax exemptions. The rate of the exemption ranges from 40 to 100 per cent and is subject to the grace period allowed.

Targets incorporated as companies are taxed under the Companies Income Tax Act. Generally, company profits are taxed at the rate of 30 per cent. In Nigeria, interest payment on sums borrowed and employed as capital in acquiring profits is tax deductible. Consequently, some businesses prefer debt financing to equity financing to enable them benefit first from the loan and subsequently from the tax deductibility of interest payments. Equity financing, whether in the form of preferred or ordinary stocks, will entitle the shareholders to dividends. Such dividends will be subject to a 10 per cent withholding tax. Upon deduction of the withholding tax, such dividend will be treated as franked investment income.

Capital gains tax payable on gains earned on the disposal of assets are not applicable to the disposal of shares. Consequently, with respect to this tax, share acquisitions are not asset acquisitions. In practice however, where it is a major transaction the revenue authorities might investigate to compare the proceeds from the sale of shares and the net book value of the assets to decide whether or not capital gains tax should arise.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Depending on the structure of a private equity transaction, loans may be sought to finance a PE transaction and such loans may be senior or subordinated debts. In practice, such loans are often in the form of senior debt. Foreign loans are subject to the relevant foreign exchange regulations and may be brought in through approved channels to enable repatriation of repayments.

Existing indebtedness of a potential target would play a role to the extent of the priority ranking of such debts and whether or not such debts are being serviced at the time of the proposed private equity transaction. As part of the structure, it may be decided to either keep or repay the existing indebtedness depending on how such repayment may affect the cash flow of the target company. The consent of the provider of the existing indebtedness would usually be required before new financing would be taken by the company.

There are restrictions under CAMA on the provision of financial assistance by a company whether by way of loan, guarantee, security, indemnity or any form or credit in relation to the acquisition of its own shares. There are also restrictions on margin loans.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

The financing provisions will depend on whether the structure is pure equity, debt, quasi-debt, leveraged or a combination. As such, it could range from fairly straightforward to very complex credit documentation. In practice, banks have traditional provisions that govern the various facilities they offer. However, it is not unusual to have debt and equity finance raised from institutional investors who are not banks. It is also important that the financier or investor ensures that the target has complied with all CAC requirements and filings for a going-private approval.

In a debt and equity financing arrangement, provisions creating conditions precedent to the investment are very usual, following the outcome of due diligence on the target entity. Further, provisions on redemption of shares, pre-emptive rights, restrictions on indebtedness, tenor, interest rate, reporting requirements, obligation of parties, tag-along rights, drag-along clauses, share transfers, anti-dilution and closing or exit, among others, are typical. The documentation may include investment or loan agreement, share sale and subscription agreement, sale and purchase agreement and shareholders' agreement.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Some transactions made prior to an insolvency may be avoided under certain circumstances, for example conveyances, mortgages, payments or other acts relating to property that amount to a fraudulent preference of creditors. Also, any conveyance or assignment of all of a company's property to trustees for the benefit of all its creditors shall be void.

These concerns are often mitigated with representations and warranties by the target company that there are no ongoing, threatened or imminent winding-up or liquidation proceedings and that a receiver or manager has not been appointed with a provision for indemnity upon breach. The scope of the warranties would further be determined by the outcome of the due diligence on the target company.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

To protect the interest of minorities, a shareholders' agreement may provide that certain decisions may be taken only if approved by a supermajority or qualified majority of the body or organ of the company making the decision. The voting threshold would therefore typically include an affirmative vote from a part of the minority. Such matters may include decisions as to the issuance of new shares, increase in share capital, acquisitions, disposals, mergers, borrowing and giving guarantees or security, related party transactions, approval of budgets, change of business plan and alteration of the constitution. The agreement may also make provision for breaking deadlocks.

There is also some statutory protection under CAMA that requires a special resolution (a resolution passed by not less than three-quarters of the votes cast) of shareholders to take the following decisions:

- a change of name of the company;
- an alteration of the articles of association;
- a change of the objects of the company;
- variation of class rights;
- rendering the liability of the directors unlimited; and
- an arrangement or reconstruction on sale of the assets of a company.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

A takeover bid is required where a person intends to acquire 30 per cent or more of the voting rights in a public company irrespective of whether it was acquired in a single transaction or a series of transactions over time. A takeover bid can be made only if the SEC grants authority to proceed to that effect. In deciding whether or not to grant authority to make a takeover bid, the SEC would consider the likely effect of the proposed takeover bid on the economy of Nigeria and on any policy of the federal government with respect to manpower and development. A takeover bid shall not be made to fewer than 20 shareholders representing 60 per cent of the members of the target company, but it can be made to such a number of shareholders holding in the aggregate a total of 51 per cent of the issued and paid up capital of the target company.

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There is no need for a takeover bid where the shares to be acquired are shares in a private company.

For a private company, save for companies in certain sectors that are subject to industry specific regulations, any requirements for the acquisition of control will primarily be governed by the provisions of the articles of association of the company or any shareholders' agreement entered into by the shareholders or investment agreement entered with prior investors in the company.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

Contractual limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company may include provisions such as pre-emption rights, tag-along rights, restrictions on drag-along rights and put options. These rights are usually embedded in shareholders' agreements.

Also, listing requirements may limit the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company. To list on the Main Board or on the Alternative Securities Market (ASeM) of the NSE, promoters are required to retain 50 per cent of shares held at IPO for the first 12 months from the date of listing.

Further, with respect to the Main Board, the company to be listed must have a cumulative pre-tax profit of at least 300 million naira for the last three fiscal years with a pre-tax profit of at least 100 million naira in two of these years and a market capitalisation of not less than 4 billion naira at the time of listing, calculated using the listing price and shareholders' equity. Listing on ASeM does not have these requirements.

With respect to listing on the Main Board, a minimum of 20 per cent of share capital must be offered to the public and held by at least 300 shareholders. In listing on ASeM, a minimum of 15 per cent of share capital must be offered to the public and held by at least 51 shareholders.

Contractual time limitations may be agreed with respect to representations or warranties, or both, given by a private equity firm to a buyer. A private equity firm investing in a portfolio company would usually require warranties from sellers and from the management team of the target company. The said warranties may relate to compliance with applicable laws, the power to contract, title to shares and to assets.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

The holdings of the existing shareholders may be restructured for purposes of the IPO and some of the governing rights of the shareholders will survive the IPO such as representation on the board and non-compete rights. However, the company will now be subject to more regulations including the ISA, SEC Rules and Regulations and Listing Requirements.

In respect of lock-up restrictions, the Listing Requirements provide that the issuer in respect of an IPO to the Main Board of the Exchange shall ensure that the promoters and directors will hold a minimum of 50 per cent of their shares in the company for a minimum period of 12 months from the date of listing and will not directly or indirectly sell or offer to sell such securities during that period.

Subject to the lock-up restrictions, private equity sponsors or investors may dispose of their stock through a buyout, which may be by another PE entity, institutional investor or the management.

Update and trends

According to the Nigerian Bureau of Statistics, the value of capital imported into Nigeria in the second quarter of 2017 rose by US$884.1 million to stand at US$1.79 billion with portfolio investments being the main facilitator for the growth. The private equity sector also witnessed a series of transactions in diverse industries. Earlier in the year, Sahel Capital, fund managers for the Fund for Agricultural Finance in Nigeria and Cardinal Stone Capital Advisers, a Nigerian private equity fund manager, entered agreements for an investment in Crest Agro Products Limited, an integrated cassava processor based in Kogi state. In finance, the FSDH Merchant Bank, a financial services group in Nigeria, received investment funds from Advanced Finance and Investment Group, through the Atlantic Coast Regional Fund. The educational sector also had private equity transactions such as the agreement entered by Verod Capital Management, a leading West African private equity firm, to acquire a significant minority stake in Greensprings Educational Services Ltd, a 32-year old educational service provider offering pre-primary, elementary, secondary and post-secondary schooling.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

There are not many going-private transactions in Nigeria as there are few instances of public companies that have gone private, although foreign investors who want to strengthen their control of, and investments in, the companies tend to want to go private.

Transactions involving companies in some sectors such as telecommunications, electricity, insurance, financial services and the petroleum industry will be subject to further industry-specific regulation. It is yet to be verified that industry-specific regulations have limited the potential targets of private equity firms, even though such regulations make the process more elaborate.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There are few financing concerns that are unique to cross-border private equity transactions. These include tax considerations, importation of capital and repatriation at the point of exit. Where capital is to be imported in a PE transaction, the investors require a certificate of capital importation that is issued by a bank within 24 hours of the entry of the capital into the country. Obtaining the certificate of capital importation is a prerequisite for repatriation. There are no foreign investment restrictions on cross-border private equity transactions in Nigeria except for certain industries in which private participation, both local and foreign, is prohibited except with a licence from the federal government (eg, defence).

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

There are no restrictions preventing multiple private equity firms, or a private equity firm and its strategic partner, from participating in a club or group deal.

The concerns, however, depend on the relative size and interests of the parties to the transaction. In a takeover context, a key consideration for parties to such transactions is that they will likely be scrutinised for the purposes of assessing whether the obligation to make a mandatory takeover offer is triggered. The threshold for triggering this obligation is an aggregate holding of 30 per cent of the voting shares.

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20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Several issues may arise during the closing of a PE transaction. Such issues may include failure to obtain mandatory clearances or regulatory approvals and failure to satisfy financing closing conditions such as the provision of a comfort letter issued to the buyer by its lender. Where these closing issues arise, the non-defaulting party can grant an extension of time, with or without a provision for costs, to enable the resolution of the issues, or it can terminate the agreement in accordance with its terms. In the latter instance, the inclusion of a reverse termination fee clause in the agreement will be prudent.

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Saudi Arabia

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Leveraged buyouts and venture capital investments are the typical type of private equity transactions seen in the Saudi Arabian market. The market is predominantly dominated by local and regional private equity firms, sovereign wealth funds, quasi-governmental entities and family offices. Such transactions could take the form of the investor acquiring a majority stake or a significant minority interest.

Unlike in many other jurisdictions, the general partner and limited partner investment structure is not found in the Saudi market and the form of structures can vary between the following:

- direct investment by the investor into the target; or
- through a fund established by a local asset manager (the investors acquiring units in the fund and the asset manager entering into a custodian arrangement with a local custodian who will establish the vehicle that will acquire the shares of the target).

Where the investment is made by a foreign investor or a non-resident party (excluding a party considered to be 100 per cent Gulf Cooperation Council (GCC)), then foreign ownership restrictions come into play and the investment requires the approval of the Saudi Arabian General Investment Authority (SAGIA).

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Most private equity investments occur in limited liability companies or closed joint stock companies (CJSC). A private equity investment in a publicly listed company is rare and the impact of applicable corporate governance regulations on such transactions is minimal.

The corporate governance regulations (CGRs) applicable in Saudi Arabia have been issued by the Saudi Capital Market Authority (CMA) and are currently applicable only to listed companies. A copy of these regulations can be found on the CMA website (www.cma.org.sa) under the Implementing Regulations section.

Where the acquisition is being made in a limited liability company, it is normal for a private equity investor to request the legal form of the company to be converted to a CJSC either at the time of closing or as a condition subsequent, as the provisions of the companies law applicable to CJSCs regulate in more detail the framework applicable to the shareholders, the board and their committees, whereas in a limited liability company the framework can be fairly flexible and at the discretion of the parties.

However, an initial public offering is an exit mechanism that private equity investors look to incorporate in their documentation. Therefore, the application of the CGRs would be relevant where the legal form of the target is to be converted to a listed joint stock company to enable the exit. As one of the listing requirements, the company would be required to adopt a code of corporate governance (Code) that is based on the CGRs. This Code would include, but would not be limited to, providing guidance for:

- rights of shareholders;
- rights related to general meetings;
- responsibilities and terms of reference of the board of directors;
- board of directors processes;
- conflicts of interest;
- board committees;
- internal and external auditor; and
- disclosure and transparency.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

The entry into of a going-private or a private equity transaction by a listed company would be rare. However the issues likely to be considered by the board of a listed company for such a transaction would include, but would not be limited to, the following:

- ensuring that announcements relating to the transaction are made in a timely manner;
- the requirements of the CMA's Merger and Acquisition Regulations are followed;
- disclosures relating to any related parties involved in the transaction are made and approved by the general meeting of shareholders; and
- all direct or indirect conflicts of the directors are recorded and approved.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

As going-private transactions are not common, it is difficult to comment on what sort of disclosures would be required in this scenario. It is likely that procedural requirements of the CMA Merger and Acquisition Regulations would need to be followed, including the requirement to make announcements in relation to any tender offer.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The timing considerations (and processes) can vary depending on the legal form of the target entity and also the nationality of the private equity investor or other existing shareholders of the target (for, as mentioned above, if there is any element of a foreign national (excluding a

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100 per cent GCC national), a foreign investment license from SAGIA will need to be obtained as part of the regulatory approval for the transaction).

Acquisition of shares in a limited liability company

The acquisition of shares in a limited liability company will entail:

(i) preparing an amendment to the articles of association (Amendment) of the target company to reflect the name of the investor and exit (if applicable) of any shareholder, including identifying in the capital provision, the relevant shares and percentage to be owned by each party. Current Ministry of Commerce & Investment (MOCI) practice is to restate the articles of association;
(ii) seeking the approval of MOCI on the Amendment;
(iii) executing the Amendment before a competent notary in Saudi Arabia, either in person or through representation;
(iv) publication of the Amendment on the MOCI website; and
(v) updating the commercial registration of the target.

If a foreign investment licence is required to be obtained from SAGIA or amended as part of the process, then the same will be processed prior to commencing with the MOCI steps identified in (i) to (v) above.

Share transfers in a limited liability company are subject to rights of pre-emption in favour of the existing shareholders, and these will need to be waived as part of the process (such waiver usually obtained in the form of the Amendment).

The parties are required to provide documents in Arabic, attested (and legalised if coming from abroad) and the process to transfer shares in a limited liability company can take from three to eight weeks if the SAGIA process is also involved. The timelines mentioned here are exclusive of the time taken to complete any conditions precedent.

Acquisition of shares in a CJSC

To the extent that a foreign investment licence is not required or does not need to be updated as part of the process, closing a transaction in a CJSC is a much simpler process and requires the preparation and execution of the share transfer instrument, and updating the share register of the target to register the transfer of shares.

If an amendment to the by-laws is required as part of the closing of the acquisition, then a shareholders' general meeting will be required to approve the amendments to the by-laws, and a minimum of 10 days' notice is required for such meeting. The general meeting approvals must be obtained prior to effecting the share transfer and once obtained, the share transfers can be completed in one business day. Post-completion the commercial registration of the target will need to be updated to reflect any amendments to the target's board of directors.

The founding shareholders of a CJSC are restricted by the Companies Law from transferring their shares to a third party for a period of two fiscal years of not less than 12 months, commencing from the date of incorporation of the company or from the date of conversion from a limited liability company to a CJSC. This restriction is important to note from an exit perspective, if at the time of entry, the investor had required the legal form of the company to be converted from an limited liability company to a CJSC.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Dissenting shareholder rights in a limited liability company

Pursuant to the provisions of the Companies Law, all shareholders in a limited liability company enjoy rights of pre-emption in the case of a proposed share transfer by a shareholder or issuance of new shares by the company. These pre-emption rights need to be waived (such waiver usually obtained in the Amendment). Additionally, each shareholder is required to be present in person or represented by attorney before a notary for the signing of the Amendment and therefore a dissenting shareholder has the ability to frustrate the closing of a transaction.

Dissenting shareholder rights in a CJSC

Shareholders in a CJSC, unless subject to a contractual agreement, are not subject to any pre-emption rights on a share transfer and therefore, while legally there is no requirement for all shareholders to agree to the deal, from a commercial perspective and to avoid any issues around closing it would be recommended to inform the other shareholders. However, if the investor is acquiring shares in the CJSC through a share subscription, then the capital increase (and the corresponding change in the by-laws) would need to be approved by an extraordinary general assembly of the shareholders and the existing shareholders would also need to waive their rights of pre-emption over the issuance of the new shares by the company.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

A purchase agreement in Saudi Arabia will contain all the usual provisions found in similar agreements in other jurisdictions. The buyer will insert a list of conditions precedent reflecting items arising from its due diligence; private equity investors will look to incorporate additional conditions relating to the raising of funds, which in certain instances a seller will look to resist; the seller will be required to provide a full suite of representations and warranties, covering authority, ownership of the shares and over all business items; the claims' provision will contain a de minimis amount, a basket of claims and a cap on liability (usually linked to the business representations and warranties); and it is usual to find private equity investors imposing restrictive covenants on a seller.

It is common for private investors to push for purchase price adjustments, and it is becoming a common feature of purchase agreements in Saudi Arabia to find either the locked box approach or the post-completion accounts mechanism.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In Saudi Arabia the most common means of incentivising the management would be through entering into new employment contracts with the key personnel. Equity-based incentives are not common and consideration would have to be given to their structure and enforceability. For example, a limited liability company does not issue shares, and therefore any equity incentive award would require the name of the employee to be registered in the articles of association of the company as a shareholder (which may create practical difficulty given the regulatory approval process for the articles of association) and any change in such would require the employee to attend before a notary or be represented thereat.

Shares are issued in a CJSC and it may be possible to provide share incentive schemes in this type of company.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The impact of tax is an important element that needs to be dealt with upfront in the structuring of a transaction.

In Saudi Arabia, a Saudi or a GCC national pays 2.5 per cent zakat on its investment and any income generated on a sale of shares would also be subject to 2.5 per cent zakat. However if the investment by the Saudi investor or GCC investor is made through an offshore vehicle (ie, non-resident in Saudi Arabia), then a 5 per cent withholding tax will be applied on any dividend distribution and the sale of shares would trigger a 20 per cent capital gains tax on the capital gain arising from such sale.

The investment of a foreign investor would be subject to a 20 per cent income tax and withholding tax on dividend distribution and capital gains tax on the sale of shares would apply as mentioned above.

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At times, private equity firms look to structure their investment through a vehicle established in the Dubai International Financial Centre. The tax implications of such structures should always be considered before implementation.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

There are no restrictions on a purchaser arranging debt finance to fund the purchase price paid for the shares of the target. It is then usual for the purchaser to settle the existing debt. To the extent any indebtedness remains, then consents from the existing lenders or notice to the existing lenders will need to be obtained prior to closing (usually catered for in the conditions precedent).

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

A purchaser will seek to incorporate in the purchase agreement a condition precedent around arranging acquisition finance for the purchase. However, the documentation to be entered into with the lender will be recorded in a separate arrangement, through typical financing and security documentation.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

While it is common for a purchaser to include detailed ownership and title issues through the warranties in the purchase agreement, fraudulent conveyance transfers have not been common in the Saudi market. Ownership and title warranties are treated as fundamental warranties, and usually covered in the purchase agreement with a right for the purchaser to rescind the contract, in the event of breach. As a measure of good practice it is recommended to obtain a print-out from MOCI, as such print-out will show the names of the shareholders of the company (as registered with MOCI).

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

A minority shareholder will seek to include the following protections in a shareholders agreement:

- board representation (including quorum for a board meeting to be achieved only when the board member representing the minority shareholder attends the board meeting);
- reserved matters both at the shareholder and board level to ensure that the minority shareholder has a right to approve or reject matters considered critical to its investment;
- share transfer restrictions including a right of pre-emption or tag-along by the minority investor; and
- access to company information, books and records.

It is recommended to try to reflect the above shareholder rights in the constitutional documents of the company, but this requires discussion with MOCI. Practice shows that there may be more flexibility to reflect some if not all the rights mentioned above in the articles of association of a limited liability company, while for a CJSC current MOCI preference is to adopt their standard form and therefore it may difficult to entrench some of these rights in the by-laws of a CJSC.

Additionally, a private equity investor will look to capture various exit mechanisms in the shareholders' agreement. Exit mechanisms could include:

- sale of shares in an initial public offering or a priority right to sell shares in an initial public offering;
- sale of shares to a strategic investor; or
- a put option requiring the other shareholders to purchase its shares.

Under Saudi law, call and put options are unlikely to be unenforceable as they are deemed promises to buy and sell something in violation of *shariah* principles as applied in Saudi Arabia. However, it is common to include these items, as a party may honour its contractual obligations.

Shareholders in a limited liability company enjoy various protections given that any matter that affects the articles of association of a company (such as the name and details of the shareholders of the company, the objects of the company, the capital structure, the governance structure, dividend distribution) are all reflected in the articles, and if any such item were to be changed, then this would require an amendment to the articles that would need to be signed by, or on behalf of, all shareholders before a competent notary.

In a CJSC, there are certain items that require unanimous shareholder approval and these relate to:

- changing the company's nationality;
- moving the company's head office to a location outside Saudi Arabia;
- increasing the financial burden of the shareholders; and
- depriving a shareholder or amending its fundamental rights as a shareholder in the company.

Other matters (including amendments to by-laws) require extraordinary general meeting approval.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

If a private equity investor is seeking to acquire control of a limited liability company or a CJSC, then subject to any foreign ownership restrictions applicable to the industry in which the target operates, there are no impediments or requirements for the proposed acquisition.

However, an acquisition of a controlling stake in a public company will trigger the CMA Mergers and Acquisitions Regulations, which set out in detail the specific rules relating to mandatory and permitted tender offers.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

If the private equity investor is looking to sell its shares in a limited liability company, then it needs all shareholders of the company to approve the deal, as, for the reasons mentioned earlier, the process will require an amendment to the articles of association of the company, and in practice, all shareholders must attend and sign the amendment before a competent notary.

It is usual that a shareholders' agreement would be in place in a CJSC between the private equity investor and all other shareholders and such shareholders' agreement would usually contain restrictions on the transfer of shares (including rights of first refusal, pre-emption rights, drag-along, tag-along, etc). Therefore, while there is no regulatory impediment to a transfer of shares in a CJSC (assuming that the lock-in period imposed by law has expired), there may be contractual limitations that need to be considered prior to proceeding with a sale.

A listing of the company requires various corporate authorisations including resolutions and declarations signed by all directors. Accordingly, a private equity investor on its own could not manage a

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Update and trends

A buyer obtaining insurance coverage for representations and warranties for deals in the Saudi market would still be considered novel, and we expect this to be an area of practice that will develop in the coming years.

listing of a company and will require the support of all shareholders and their representative directors.

As regards post-closing recourse against a private equity seller, the concept of indemnity and warranty insurance is still novel for the Saudi market and the norm remains for the buyer and the seller to agree a claim's liability period and cap on liability. Private equity sellers push for a claim period surviving not longer than one audit cycle and the cap on liability will be linked to a percentage of the purchase price. However, in certain limited cases where the private equity investor is selling shares along with another seller who was the controlling shareholder (such seller not being a private equity firm), private equity investors have resisted taking the obligation for any liability for any post-closing recourse. It is not common for a private equity seller to agree to hold a certain amount of the purchase price in escrow until the end of the claims liability period (and the escrow arrangement in such instances would be more common when the private equity firm is the purchaser).

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

It is rare for a shareholders' agreement between the shareholders in a CJSC to survive upon the listing of the company and upon listing all governance matters and rights of shareholders would be subject to the by-laws of the company and the CMA Corporate Governance Regulations. A listed company must comply with the CGRs, some of which include:

- appointment of a prescribed number of independent and non-executive directors to the board;
- appointment of an audit committee and its composition;
- appointment of a remuneration committee and its composition;
- appointment of a nomination committee and its composition; and
- adoption of a corporate governance code for the company that does not contradict the provisions of the Corporate Governance Regulations.

The CMA requires that all founding shareholders of a company listing on the main market be subject to a lock-up period. In the past, the lock-up period was generally six months from the date that the shares of the issuer commenced trading on Tadawul (ie, the Saudi stock exchange). However, in some cases, the CMA had requested that the restrictions on founding shareholders remain for five years (as was the case with telecommunications companies). The CMA now considers each issuer on a case-by-case basis and determines a suitable lock-up period for the founders.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

As mentioned above, going-private transactions are not common and therefore it is difficult to comment on industry trends.

Subject to any foreign ownership restrictions (discussed below), there is no restriction on the potential targets of private equity firms. Recent transactions involving private equity firms have been seen in the fast-service restaurant business, healthcare and education sectors.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

A foreign investor (excluding a 100 per cent GCC national) will be required to obtain a foreign investment licence from SAGIA prior to completing the acquisition. Obtaining this licence requires the submission of various documents on behalf of the investor (including the provision of audited financial statements, board or shareholder resolutions, and other corporate documents). All documents coming from abroad need to be notarised and legalised by the Saudi embassy or consulate in the jurisdiction and thereafter translated into Arabic before submission. Preparing these documents requires some lead time.

A 100 per cent foreign investment is possible in the industrial and service sectors. However, if a foreign investor were considering acquiring shares in a trading entity in Saudi Arabia, then as a general rule such investment would be subject to a maximum shareholding of 75 per cent of the share capital and a minimum capital contribution of 20 million Saudi riyals by the foreign shareholder. Pursuant to a recent change in law, while it is possible to establish or acquire a 100 per cent ownership in trading entities, the conditions relating to such investment are stringent.

Additionally, there is a negative list prescribed by SAGIA that lists activities in which foreign participation is not permitted in Saudi Arabia. A potential investor must consider this list before considering the investment.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

For such transactions, we are seeing parties enter into co-investment arrangements pursuant to which the private equity firm controls the investment, including the exit options, and prefers that the strategic investor play a silent role. The strategic investor is mostly concerned about board representation and reserved rights for critical items. Given the practical difficulty in enforcing call and put options under Saudi law and the enforcement of security (such as pledge of shares), it is common to see the parties structuring the investment through an offshore jurisdiction (such as setting up the investment vehicle in the Dubai International Financial Centre). The implications of tax on such structures need to be considered.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

There is usually a degree of time involved between the signing of a purchase agreement and completion of the transfer and this creates the biggest concern around deal closing. The timeline is usually driven by the time required to satisfy the number of conditions precedent incorporated in the purchase agreement by the investor. These would include obtaining relevant government approvals, which may include approvals from the competition authority, SAGIA and MOCI, and operational matters such as obtaining consents under finance facilities and third-party agreements and obtaining or renewing licences and permits.

Private equity firms also look to incorporate funding conditions in the purchase agreement and, if successful, reserve the right to walk away if they are not able to raise the funds from their investors.

It is not uncommon for a private equity investor to seek compensation for a pre-mature termination of the purchase agreement on account of a failure by the seller to satisfy its conditions precedent or a breach of warranty occurring before closing, and in some agreements the parties have agreed a fixed amount to cover the costs incurred. However, even if the parties have agreed to a termination fee, if contested, such a provision may not be enforceable under Saudi law, as the general rule is that in order to be recoverable, damages for breach of contract or tort must be actual, direct and quantifiable. What constitutes actual and direct damage in a given case is a matter as to which a Saudi court will have a degree of discretion, but in principle there must be a high degree

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of certainty that a quantifiable, monetary loss has resulted or (rarely) will inevitably result from the breach in question without regard to other factors not attributable to the party in breach. The emphasis on certainty, however, makes it quite difficult to recover compensation for most kinds of losses that are classified as consequential, such as loss of anticipated profits, loss of production and the like because (except in rare cases) their occurrence is considered to be inherently uncertain or to depend on events or contingencies not directly related to the breach.

Ultimately, the points raised depend on the outcome of the negotiations between the parties, and a well-represented seller will push back on the number of conditions incorporated in the purchase agreement and also the obligation to pay any termination fees.

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Singapore

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

The growth of the Singapore private equity market mirrors the development of private equity in more sophisticated markets. The presence of global private equity houses in Asia such as Blackstone, KKR and TPG has helped to stimulate the private equity market as various funds look to put their money to work in Asia. In this regard, Singapore continues to be one of the few markets in the Asia-Pacific region where transactions can be executed efficiently and successfully in a manner that provides comfort and familiarity to private equity sponsors. Leveraged financing and security arrangements are available to support many of the leveraged transactions that are favoured by such investors. There is also a preference for techniques and structures that have been tried and tested in the United States and Europe – for example, the use of covenant-lite financing structures for Asian deals was quite prevalent before the credit crisis, and has re-emerged recently.

Take-private transactions are commonly carried out using one of the following structures:

- scheme of arrangement under section 210 of the Companies Act (Chapter 50 of Singapore) (Companies Act);
- general offer pursuant to the Singapore Code on Takeovers and Mergers (Takeover Code), coupled with compulsory acquisition under section 215 of the Companies Act; and
- voluntary delisting pursuant to Chapter 13 of the Listing Manual of the Singapore Exchange Securities Trading Limited (SGX) (which also requires an exit offer governed by the Takeover Code), coupled with compulsory acquisition under section 215 of the Companies Act.

Other forms of transactions that are typical in this market include start-up investments and venture capital-type activities, as well as management buyouts (MBOs), management buy-ins or buy-in management buyouts with management rollover arrangements.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Companies listed on the SGX are subject to enhanced corporate governance rules, including the following:

- the Guidebook for Audit Committees in Singapore identifies the key regulatory responsibilities and best practices of audit committees and addresses practical issues of concern to audit committee members, including the implications of the requirements under the Companies Act, the SGX listing rules as well as the principles and guidelines of the Code of Corporate Governance (the 2012 Code);
- the SGX listing rules contains rules intended to enhance corporate governance practices and foster greater disclosure to safeguard shareholders' interests. For example, the SGX listing rules require, inter alia, the following:
  - in respect of the appointment of key officers, listed companies are required to obtain the SGX's approval prior to the appointment of directors, chief executive officers and chief financial officers under certain circumstances and, in respect of the cessation of key officers, such key officers are to inform the SGX as soon as possible of any irregularities in the listed company that would have a material impact on the listed group. A listed company is also required to disclose when an independent director of the listed company is appointed to or has ceased to be on the board of the listed company's principal subsidiaries based outside of Singapore;
  - in respect of share-pledging arrangements, a listed company must obtain undertakings from its controlling shareholders to notify it of any such share-pledging arrangements and of any event which may result in a breach of loan covenants entered into by the listed company (including an enforcement of such share-pledging arrangements that may result in a change in control of the listed company), and the listed company, upon notification by such shareholders, is required to disclose details of the shareholders and share-pledging arrangements; and
  - in respect of the holding of general meetings, since 1 January 2014, all listed companies (whether incorporated in Singapore or elsewhere) with a primary listing in Singapore are required to hold their general meetings in Singapore to promote more active participation and engagement of shareholders. Where there are legal constraints preventing them from holding their general meetings in Singapore, alternative modes of engagement such as webcast and information meetings should be provided so that public shareholders have access to the board and senior management; and
- the 2012 Code contains provisions relating to the composition of the board of directors in specified circumstances and disclosures in annual reports, the large majority of which took effect in relation to financial years commencing from 1 November 2012. In relation to the composition of the board of directors, the 2012 Code requires the board of directors of a listed company to meet more stringent independence requirements. For example, the definition of 'independent director' has been refined to mean a director who does not have any relationship with the company, its related corporations, its 10 per cent shareholders or its officers that could interfere or be reasonably perceived to interfere with his or her independent business judgment. This is a notable change from the previous position where a director could be considered independent even when he or she has a relationship with the shareholders. In addition, under the 2012 Code, the independence of any director who has served beyond nine years from his or her first appointment will be subject to particularly rigorous review. Another significant amendment is the introduction of new guidelines requiring directors of a listed company to give an opinion on the adequacy and effectiveness of the internal controls within the company. There is also now a similar requirement under the SGX listing rules for such an opinion to be disclosed in the annual report of the listed company.

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In 2015, the SGX increased its scrutiny on the compliance by listed companies with the 2012 Code. On 29 January 2015, the SGX released a disclosure guide in a Q&A format to assist listed companies in complying with their obligations under the 2012 Code, with listed companies being encouraged to enclose the same in their annual reports. On 12 October 2015, the SGX further announced the appointment of an external auditor to conduct a review of listed companies' compliance with the 2012 Code (the Compliance Review), as part of the SGX's drive to raise corporate governance standards. In July 2016, the SGX announced the results of the Compliance Review. According to the Compliance Review, adherence to guidelines of the 2012 Code can be improved, deviations should be better explained and disclosures on remuneration matters were most in need of improvement, particularly the amount of remuneration paid to directors, CEOs and key management personnel, the details on the performance metrics for directors and key management personnel and how performance and remuneration are aligned. The SGX also introduced sustainability reporting on a 'comply or explain' basis in June 2016, requiring companies to publish a sustainability report at least once a year, no later than five months after the end of each financial year beginning on the financial year ending on, or after, 31 December 2017.

The corporate governance framework discussed above applies to all companies listed on the SGX and will cease to apply when the company is delisted. Likewise, the SGX listing rules will only cease to apply to a company that has been privatised and delisted from the SGX. In light of this, one key benefit of a going-private transaction is the cost-saving associated with the reduced regulatory, audit and compliance costs. For the private equity sponsor that takes the company private, there is the added advantage of limited public disclosure requirements and greater flexibility in appointing directors to the board of the target company.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

The directors of a Singapore public listed company owe fiduciary duties to act in the best interests of the company, including in the context of a going-private transaction. Similar fiduciary duties apply to directors of a Singapore private company involved in a private equity transaction.

The critical issue that directors need to grapple with in a going-private transaction is to determine whether there are conflicts of interest that may affect certain members of the board by reason of their participation or shareholding in the bidding vehicle or as part of the MBO. This is important for private equity transactions as private equity investors are typically concerned with ensuring management continuity and seek to do so by incentivising management to participate in the bidding vehicle. In this regard, they would need to consider what role (if any) the existing management would play in the bidding vehicle. To address the issue of a potential conflict of interests, a company that is subject to an MBO (or going-private transaction) will typically establish a special committee of directors comprising directors who are independent for the purpose of the offer, to have oversight of the transaction.

Pursuant to the Takeover Code, the special committee is expected to appoint an independent financial adviser to assist in the recommendation that has to be made by the directors on the transaction. In some recent going-private transactions that have been conducted by way of auction, the special committee has involved a financial adviser at an early stage in the process. In such circumstances, a separate independent financial adviser has been appointed to opine on the transaction from a financial perspective and advise the independent directors for the purposes of the transaction. The early involvement of an independent financial adviser is also recommended where the going-private transaction is structured as a voluntary delisting proposal, since the SGX expects the independent financial adviser's opinion on the reasonableness of the exit offer to be included in the delisting application submitted by the target company to the SGX and in the shareholders' circular.

In the context of an MBO, the special committee will need to be mindful as to how information is disclosed to a bidding vehicle that includes members of the management team. If the disclosure process is not carefully managed, any inadvertent disclosure to such a bidding vehicle may result in the target company being compelled under the Takeover Code to disclose the same information to a competing offeror that may subsequently surface. The independence of a director will also affect his or her ability to make a recommendation on the transaction to the shareholders of the target company for the purpose of the Takeover Code. As a starting point, the Takeover Code requires all directors of the target company to make a recommendation on the transaction. Where a director wishes to be exempted from making such a recommendation, the consent of the Securities Industry Council (SIC) must be sought. The SIC has made clear in note 1 to rule 8.3 of the Takeover Code that they will normally exempt a director who is not independent from assuming any responsibility for making a recommendation on the offer to the shareholders of the target company. However, such a director will still need to assume responsibility for the accuracy of the facts stated in the announcements and documents that are despatched to the shareholders of the target company.

In the context of a going-private transaction, one query that has frequently been raised by the special committee relates to the requirement on, or ability of, the special committee to seek competing offers. The Takeover Code was amended by the SIC in February 2016 (the 2016 Takeover Code Amendments) to clarify that, inter alia, offeree boards may consider the feasibility of soliciting a competing offer or running a sale process and that doing so will not amount to frustration of the initial offer, given that a better or alternative offer is generally in the interest of the shareholders of the target company.

Finally, boards of public listed companies should bear in mind that, Takeover Code issues aside, any material price-sensitive information disclosed in the course of the transaction may also give rise to concerns of insider trading under the Securities and Futures Act (Chapter 289 of Singapore) (the Securities and Futures Act).

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The disclosure requirements in a going-private transaction are the same whether the transaction is implemented by way of a general offer under the Takeover Code or by way of a scheme of arrangement under section 210 of the Companies Act.

The Takeover Code prescribes the relevant information that needs to be disclosed (in the context of a general offer) in an offer document issued by the bidding vehicle and the circular issued by the target company to its shareholders; and (in the context of a scheme of arrangement) in the scheme document to be issued by the target company. For example, details of any shareholdings in the target company and any dealings in such shares by parties involved in the going-private transaction and their concert parties during the three-month (in the case of a voluntary offer) or six-month (in the case of a mandatory offer) period prior to and during the offer period must be disclosed in the offer document and the circular issued by the target company to its shareholders. For securities exchange offers, the same information relating to shares of the bidding vehicle must be disclosed.

The Takeover Code also requires prompt disclosure of securities dealings by parties involved in the going-private transaction and their associates during the offer period, which essentially commences when a possible takeover offer is made known to the public. Depending on the nature of the dealings, a party may either be compelled to make a public disclosure or a private disclosure to the SIC.

Previous amendments to the Takeover Code in 2012 introduced enhanced disclosure requirements that include the requirement for the bidding vehicle to disclose if the shares it holds in the target company are charged, borrowed or lent, and the requirement for disclosure of dealings in convertible securities, options, warrants and derivatives during the offer period by persons holding or controlling 5 per cent or more of the underlying class of securities, where such instruments cause the holder to have a long economic exposure to the underlying securities. The 2016 Takeover Code Amendments further require prompt disclosure of any material changes to information previously

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published in connection with the offer and any material new information that would have been required to be disclosed in any previous document or announcement published during an offer period, had it been known at the time.

The Companies Act and the Securities and Futures Act impose separate disclosure obligations on parties who become substantial shareholders of a Singapore public listed company (namely, upon acquiring an interest in shares representing 5 per cent or more of the voting rights of the company) and any subsequent percentage level changes in their substantial shareholding. Under the Securities and Futures (Disclosure of Interests) Regulations 2012, promulgated to facilitate the new streamlined disclosure regime implemented by the Monetary Authority of Singapore (MAS) on 19 November 2012, a bidding vehicle is exempted from complying with disclosure obligations under the Securities and Futures Act in respect of any change in its interest in the securities of the target company during the offer period, provided that the bidding vehicle complies with the disclosure obligations under the Takeover Code.

In addition, in order to enhance transparency in line with international standards for combating money laundering, terrorism financing and other related threats to the integrity of the international financial system, the Companies Act was recently amended with effect from 31 March 2017 (the 2017 Companies Act Amendments) to require (subject to certain exceptions) Singapore companies and foreign companies registered under the Companies Act to maintain and update a register disclosing the details of registrable controllers, which would include persons:

- with an interest in more than 25 per cent of the shares or voting power in a company; or
- who possess the right to appoint or remove the directors of such company who hold majority voting rights at directors' meetings.

The 2017 Companies Act Amendments also impose an obligation on a person who knows or ought reasonably to know that he or she is a registrable controller of a company, or that a relevant change in his or her particulars has occurred, to notify the company and provide the relevant information. Unlike several other jurisdictions (eg, the UK and Hong Kong) where similar registers are made public, however, the said registers are only available for inspection by the Singapore Registrar of Companies and other public authorities (on request), and companies are expressly prohibited from disclosing the same to members of the public. In line with these new requirements, bidding vehicles and their beneficial owners may (subject to certain exceptions) be required to provide a target company with the relevant information for the purpose of updating the latter's register of registrable controllers upon the successful acquisition of shares in the latter.

Prior to 1 December 2015, companies listed on the SGX or its listed shareholders had to, depending on the circumstances, privately notify the SGX where its board was either aware of discussions or negotiations of a potential proposal, or in discussion or negotiation on an agreement or document that might lead to a takeover, reverse takeover or a very substantial acquisition by the company (Selected Transaction). Companies listed on the SGX were also required to maintain a list of persons who were privy to a Selected Transaction in a prescribed format and such list was to be furnished to the SGX upon request. With effect from 1 December 2015, companies listed on the SGX or its listed shareholders need not privately notify the SGX of such transactions prior to a public announcement and the privy persons list requirement has now been extended to all material transactions.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

In general, the timing of a private equity transaction in Singapore depends to some extent on the scope of due diligence and on the requirement to clear specific regulatory issues, for example, merger control issues under the Competition Act (Chapter 50B of Singapore). The merger control regime in Singapore may potentially extend a transaction by three months or more in a case where the transaction is subject to review by the Competition Commission of Singapore.

A going-private transaction may be structured either as a general offer subject to the Takeover Code or a scheme of arrangement subject to both the Takeover Code and the Companies Act. In the case of a general offer that is subject to the Takeover Code, a specific timeline is set out in the Takeover Code that prescribes when the bidding vehicle is required to do certain acts and when a response is expected from the target company. On the other hand, a scheme of arrangement, with the consent of the SIC, is typically exempted from the timeline prescribed under the Takeover Code.

In the case of a general offer under the Takeover Code, the parties are expected to adhere strictly to the timeline in the Takeover Code once a firm intention to make an offer is announced by the bidding vehicle. This announcement will set the timeline in motion and the bidding vehicle must despatch the offer document setting out the terms and conditions of the offer as well as the acceptance procedures to the target company's shareholders, no earlier than 14 days and no later than 21 days from the offer announcement date. The target company is then obliged to respond with a circular to its shareholders containing the advice of an independent financial adviser and the recommendation of the directors of the target company. Such circular is to be despatched within 14 days of the date of posting of the offer document. The Takeover Code also imposes a timeline with respect to how long the offer can remain open and the circumstances under which the offer may be extended. Depending on whether the general offer is made subject to specific conditions that are permitted by the SIC, the offer will either lapse from a failure to satisfy such conditions or close successfully.

If at the close of the offer, the bidding vehicle acquires sufficient shares in the target company (either pursuant to valid acceptances of the offer or market purchases during the offer period) to cross the 90 per cent threshold under section 215 of the Companies Act, the bidding vehicle may proceed to 'squeeze out' the remaining non-accepting shareholders by invoking the compulsory acquisition procedure under the same section. This process typically extends the transaction timetable by another two months before all the remaining shares are transferred to the bidding vehicle and the target public company becomes a wholly owned subsidiary of the bidding vehicle. The bidding vehicle has up to four months from the making of the general offer to cross the 90 per cent threshold under the Companies Act to avail itself of the compulsory acquisition rights under section 215 of the Companies Act. With effect from 3 January 2016, section 215 of the Companies Act has been amended to allow the bidding vehicle to also acquire options and other interests in shares. It should be noted that the 90 per cent threshold only applies to Singapore-incorporated target companies. For foreign target companies listed on the SGX, the bidding vehicle would have to refer to the squeeze-out mechanism and timing considerations under the laws of incorporation of such foreign target companies.

A bidding vehicle may also effect a going-private transaction by way of a scheme of arrangement under section 210 of the Companies Act. Unlike a general offer where the bidding vehicle may find itself unable to achieve the 90 per cent requirement to squeeze out the minority shareholders despite its success in acquiring a majority stake in the target public company, a going-private transaction undertaken by way of a scheme of arrangement guarantees an 'all or nothing' result. The key timing consideration of a scheme of arrangement relates to the preparation of the scheme document that has to be reviewed by the SGX before its despatch to shareholders. The drafting and review process may take up to eight weeks following the joint announcement by the bidding vehicle and the target company of the proposed scheme of arrangement. Once cleared by the regulators, the target company will have to apply to the High Court of Singapore for leave to convene a meeting of the shareholders (or meetings of different classes of shareholders, if appropriate) to consider and vote on the proposed scheme of arrangement. Upon the granting of leave, the target company has to despatch the scheme document to its shareholders and give at least 14 days' notice to convene the meeting(s). The scheme of arrangement must be approved by a majority in number representing 75 per cent in value of the shareholders present and voting at each meeting. The SIC will normally require the bidding vehicle and its concert parties and the common substantial shareholders of the bidding vehicle and the target company to abstain from voting on the scheme of arrangement. Once approved by the requisite majority of shareholders, the target company has to obtain the consent of the High Court for the scheme. A scheme of arrangement approved by shareholders and the High Court will bind all the shareholders in the target company and will take effect upon the lodgement of the relevant court order with the Accounting

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and Corporate Regulatory Authority. Unless an objection is raised at the Court hearing, a going-private transaction undertaken by way of a scheme of arrangement is likely to complete within four months of the date of the initial joint announcement, subject to the schedule of the SGX and the High Court.

A third structure for implementing a going-private transaction in Singapore is via a voluntary delisting proposal and exit offer. However, this structure is more commonly adopted by a private equity sponsor who already has an existing majority stake in the target company and where the minority shareholders either do not hold significant shareholding blocks or the bidding vehicle is confident of garnering the support of significant minority shareholders. From a timing perspective, this process will still typically take longer to complete when compared to a general offer under the Takeover Code as the SGX and shareholders' approval at a general meeting will need to be obtained. In some going-private transactions in Singapore, a voluntary delisting proposal is used as a follow-up step to take the target public company private following an initial voluntary offer that does not result in the bidding vehicle receiving sufficient acceptances to enable it to squeeze out the minority shareholders under the compulsory acquisition provisions in the Companies Act.

Where the Takeover Code does not apply to a private equity transaction, there will generally be no fixed timeline that a bidding vehicle must comply with.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Depending on how the going-private transaction is structured, dissenting shareholders may exercise their voting rights to vote against the transaction or apply to the Singapore courts for relief.

In respect of a scheme of arrangement, a majority in number representing 75 per cent in value of the shareholders present and voting at each meeting must approve the scheme, with the bidding vehicle and its concert parties, and the common substantial shareholders of the bidding vehicle and the target company, normally being required to abstain from voting. Given the need to satisfy the 'majority in number' approval requirement, a sufficient number of dissenting shareholders turning up at the meeting may still 'block' the scheme from being approved. In addition, notwithstanding that such approval is obtained, a dissenting shareholder still has the right to attend and raise objections at the court hearing in respect of the scheme.

In respect of a voluntary delisting, a delisting resolution must be approved by a majority of at least 75 per cent of the total number of issued shares held by shareholders present and voting (on a poll). However, the voluntary delisting cannot proceed if dissenting shareholders, holding at least 10 per cent of the total number of issued shares held by shareholders present and voting (on a poll), attend the meeting and vote against the delisting resolution.

Where the general offer or voluntary delisting is coupled with compulsory acquisition under section 215 of the Companies Act, dissenting shareholders may apply to court within one month of the date on which the notice of compulsory acquisition is given, to object to the transaction.

As a general principle under the Takeover Code, rights of control over the target public company must be exercised in good faith and the oppression of the minority is wholly unacceptable. In addition, if the going-private transaction is carried out in a manner that is oppressive to minority shareholders, the Companies Act provides minority shareholders statutory recourse to seek the intervention of the court.

Given the options available to dissenting shareholders discussed above, it is not uncommon to find potential acquirers analysing and taking into account the current shareholding spread of the target company to determine the most suitable going-private structure that maximises deal certainty and, at the same time, achieves the objective of taking the target company private with minimal execution risk. If there are significant minority holdings concentrated in a single or a few shareholders, potential acquirers will generally consider procuring irrevocable undertakings from these shareholders to support the going-private transaction to increase deal certainty.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

While most buyers in a mergers and acquisitions transaction would typically insist on comprehensive representations and warranties in the purchase agreement, going-private transactions in Singapore that are implemented following an auction process are normally concluded with minimal representations and warranties as a consequence of the competitive tension between bidders. This is particularly stark in the context of transactions implemented by way of a scheme of arrangement, as the private equity sponsor may not even be able to obtain similar comfort from the management team or a controlling shareholder to the extent that these parties do not have any agreement with the private equity sponsor.

The private equity sponsor is expected to conduct its own due diligence to get comfortable with the risks associated with the investment – vendor due diligence reports remain fairly uncommon in Singapore mergers and acquisitions transactions although there appears to be a gradual increase in its acceptance, particularly for managed auction sale processes.

A private equity sponsor would typically prefer a financing condition to be imposed as part of the purchase agreement, such that its obligations are conditional upon the availability of debt financing. However, recent Singapore private transactions suggest that such a condition would not be acceptable to most vendors. If the transaction is subject to the Takeover Code, the SIC's approval is required if the bidding vehicle wishes to include any conditions other than the normal conditions relating to the level of acceptances, approval of shareholders for the issue of new shares or the SGX's approval for listing. In particular, the SIC will normally wish to be satisfied that fulfilment of the condition does not depend to an unacceptable degree on the subjective judgment of the private equity sponsor as such conditions can create uncertainty. In addition, once an offer is announced under the Takeover Code, the SIC's consent is required before the offer can be withdrawn.

In the context of going-private transactions, the bidding vehicle's financial adviser or financier is obliged to provide a written confirmation as to the sufficiency of financial resources available to the bidding vehicle to complete the acquisition. Such a confirmation must be reflected in the announcement and the offer or scheme document to be despatched to shareholders. In a number of auction transactions, the request for financial resources confirmation is even made at the bid submission stage.

A provision of a break fee could be included in the purchase agreement of a going-private transaction. This break fee will be payable on the occurrence of certain specified events (for example, where a superior competing offer becomes or is declared unconditional as to acceptances within a specified timing or the recommendation by the board of the target public company to the shareholders to accept a superior competing offer). Under the Takeover Code, the target public company is allowed to pay a break fee of up to 1 per cent of the transaction value. The 1 per cent cap is not applicable to a private company transaction or to a break fee payable by a party other than the target public company. The directors of the target company (both public and private) must also consider their fiduciary duties in agreeing to such break fees as well as the possible breach of any financial assistance prohibition under the Companies Act. For a public transaction, the financial adviser to the target company would also be required to confirm that, inter alia, he or she believes the fee to be in the best interests of offeree company shareholders.

A private equity sponsor will also be keen to have strong indemnification provisions, often with definitive monetary limits, in order to protect his or her capital investment and calculate the minimum return. In leveraged buyouts, there is often a need to protect cash flow against unforeseen expenses and liabilities. In this regard, there is an increasing interest in exploring warranty and indemnity insurance (W&I insurance), which may be used to provide comfort to a buyer for that part of the transaction value not covered by representations and warranties or indemnities.

Finally, a private equity sponsor will also typically look to greater commitment and support for the transaction from the management of the target company to ensure management continuity. As such, it is not uncommon to find private equity sponsors insisting on the terms of the

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transaction giving them the right to negotiate with or offer to the existing management of the target company the opportunity to participate with an equity stake in the bidding vehicle or enter into new service agreements.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In a Singapore going-private transaction where the management team is actively involved in the transaction or is expected to continue its role within the target company group going forward, they are generally offered the opportunity to participate (with an equity stake) in the bidding vehicle to align its interests with the private equity sponsor. Essentially, this would typically involve the management, who hold shares in the target company, agreeing to swap their shares for equity in the bidding vehicle or tender their shares towards acceptance of the takeover offer, and thereafter apply the proceeds towards subscription for shares in the bidding vehicle. As shareholders in the bidding vehicle, the management is likely to be subject to the usual restrictions that a private equity sponsor will expect to impose in terms of voting rights and transferability of shares. On some occasions, new service agreements may be executed to document the employment terms.

A key concern in putting together management incentives in a going-private transaction is whether such incentives will constitute a 'special deal' under rule 10 of the Takeover Code, particularly where the management team are also shareholders of the target company. In this regard, note 4 to rule 10 of the Takeover Code makes it clear that the SIC will adopt the principle that the risks as well as the rewards associated with an equity shareholding should apply to the management's retained interest. Accordingly, an option arrangement that guarantees the original offer price as a minimum would normally not be acceptable. The SIC should be consulted if the management is to remain financially interested in the target company's business after the offer. The SIC may also request an independent financial adviser to issue an opinion on whether the management incentives are fair and reasonable.

The arrangements with the management would also have to be disclosed in the formal documentation that is issued to shareholders in relation to a takeover offer.

The other concern with management incentives in a going-private transaction relates to the potential conflict of interests that the management team may face in agreeing to the terms of these incentives that are applicable post-completion while the company is still publicly listed. Good corporate governance practice dictates that certain decisions on a going-private transaction may have to be dealt with by directors (or a committee of directors) who are independent for the purpose of the offer. Further, the management team may also need to abstain from participating in some of these decision-making processes.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

From a transactional perspective, most private equity bidders would be keen to ensure the following:

- minimal tax costs associated with the implementation of the transaction – for example, whether stamp duty savings are available in the context of a share transaction or if goods and services tax relief is available in the context of an asset transaction. In relation to the former, subject to certain criteria being met, the transfer of shares for certain qualifying mergers and acquisitions transactions involving Singapore companies executed between 1 April 2016 and 31 March 2020 (both dates inclusive) will be eligible for stamp duty relief, which is capped at S$80,000 for each financial year;
- interest deductibility on the debt financing that is taken for the purpose of the acquisition – where appropriate, some form of debt 'pushdown' may be explored to allow for debt refinancing at the operating company as opposed to the financing at the bidding vehicle level; and
- minimal tax leakage at the operating level post-completion – tax-related issues that are identified as part of the tax due diligence that is undertaken prior to the going-private transaction are likely to be addressed as part of the overall group restructuring that is implemented post-completion (for example, transfer pricing).

As part of any discussion on management incentives, parties would typically explore how such incentives can be provided with a view to minimising the likely increase in income tax exposure for the individual employee.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Most debt financing structures in Singapore would comprise senior secured debt in multiple tranches as well as mezzanine (and subordinated) debt. Global private equity sponsors have brought with them their preferred American or European debt financing structures when negotiating and implementing the financing structure for a Singapore going-private transaction.

Given the increasing demand by vendors to have bidders provide funding confirmation, private equity sponsors will now put in place a combination of bridge and term facilities via interim facilities agreements with their preferred banks at the point of the announcement of the going-private transaction. Refinancing may be expected within 12 months after the initial interim facilities.

While there are generally no restrictions on the use of debt financing for private equity transactions in Singapore, it is important to ensure that any debt financing structure to be implemented does not run afoul of the financial assistance provisions in section 76 of the Companies Act. On this note, it is worth pointing out that under the amendments to the Companies Act, which came into force on 1 July 2015, the financial assistance prohibition for private companies (which are not subsidiaries of public companies) has been abolished. As such, it would no longer be necessary for a private company to undergo a whitewash process before undertaking any form of debt push down or refinancing, in line with other major jurisdictions such as England. Additionally, although the prohibition is retained for public companies and their subsidiaries, a new exception has been introduced to permit a public company and its subsidiary to, subject to satisfaction of certain prescribed conditions, provide financial assistance in connection with the acquisition of its own shares if such assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Recent going-private transactions suggest that in an auction process a private equity sponsor will need to be able to show the vendor or target company the equity commitment letters and bank financing confirmation as early as the bid submission stage. This compels the private equity sponsor to line up the financiers at the outset of the transaction and have them sign up to commitment letters and interim facilities agreements to establish the requisite debt financing. The financial adviser to the private equity sponsor will need to review these documents and be satisfied that the bidding vehicle has sufficient financial resources to satisfy the consideration payable for the target company. This review is necessary as the financial adviser is usually expected to issue a confirmation of financial resources and a request for such

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confirmation can be made as early as the bid submission stage. The review also addresses in part the financial adviser's due diligence obligation under the Takeover Code on the issue of adequacy of financial resources.

Once the going-private transaction is announced, the lenders and the private equity sponsor will then move on to negotiate the formal loan documentation and the security documentation. Singapore lenders have come to accept that they may not always have the security in place at the point of completion of the acquisition because of the need to either convert the delisted public company into a private company or to complete financial assistance whitewash procedures. In many instances, parties agree to a time frame pursuant to which the delisted public company is either converted into a private company or the financial assistance whitewash procedure must be undertaken and the security documentation is executed thereafter.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Singapore insolvency laws allow liquidators and judicial managers of a Singapore company to exercise limited powers to have a Singapore court set aside certain transactions that may be regarded, for example, as transactions at an undervalue or transactions where unfair preferences are given. These concepts are based on UK insolvency legislation. We would expect representations and warranties to be given to the contrary in the financing documentation.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

A private equity sponsor will typically focus on provisions in shareholders' agreements that facilitate transfer of their shares via the usual exit mechanisms. To the extent that the management team rolls over its equity and participates in the bidding vehicle, the private equity sponsor can be expected to impose lock-up arrangements, as well as pre-emption rights over the shares of the management team, and restrict their ability to control the decision-making process over the management of the target company. The 'reserved matter' list for the management team is usually kept short. The concepts of 'good leavers' and 'bad leavers' are commonly found in the shareholders' agreement to deal with the exit price payable to a member of the management team who leaves the group. Registration rights are usually incorporated for the benefit of private equity sponsors looking to exit via a public offering in the United States. Non-compete and non-solicitation provisions are also commonly found in the shareholders' agreements for private equity sponsors.

With regard to the issue of statutory or other legal forms of protection available to minority shareholders, the constitution (or equivalent, eg, memorandum and articles of association) (Constitution) provides a basic layer of protection for minority shareholders. A company cannot act in breach of its Constitution and an aggrieved minority shareholder may commence legal action to prevent a threatened breach. The Companies Act protects the minority shareholders against unbridled variations of the provisions in the Constitution by requiring a special resolution to be passed by a majority of not less than three-quarters of the shareholders of the company who are present and voting at the meeting to vary any provision in the Constitution.

Minority shareholder protection against oppression is provided for in section 216 of the Companies Act, which allows minority shareholders to seek the intervention of the court where the following is true:

- the affairs of the company are being conducted or the powers of the directors are being exercised in a manner oppressive to one or more shareholders, or in disregard of his or her or their interests as shareholders; or
- some act of the company has been carried out or is threatened, or that some resolution has been passed or is proposed that unfairly discriminates against or is otherwise prejudicial to one or more shareholders (including the minority shareholder making the complaint).

The Singapore courts have wide powers to remedy or put an end to the matters of complaint. Aggrieved minority shareholders may bring an action on behalf of the company against wrongdoers where a wrong is done to the company (instead of the minority shareholders directly) pursuant to the common law right of derivative action. This avoids the situation where the minority shareholders are unable to seek a judicial remedy owing to the majority's efforts in stifling any potential claims against themselves. The statutory derivative action under section 216A of the Companies Act supplements the common law right. However, the statutory derivative action is not available to shareholders of foreign-incorporated companies.

Other statutory and legal protection accorded to minority shareholders include the various requirements under the Companies Act for shareholders' approval by special resolution for certain major corporate actions proposed to be undertaken by the company. For example, such shareholders' approval is required for capital reductions, certain types of share buybacks and winding up by a resolution of the shareholders. Shareholders are also given the basic rights to inspect certain statutory registers (including the register of members of the company) and minute books, as well as to receive the audited financial statements (and related documents) of the company.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

The ability of an acquirer to acquire control of a private or public company may be subject to the usual merger control regulations and relevant regulatory approvals being obtained in the case where the target company is operating in a tightly regulated industry, such as banking, broadcasting and newspaper publications.

With regard to public companies where the Takeover Code applies, the relevant requirements depend on the structure of the transaction contemplated.

An acquisition or consolidation of effective control of a target public company (or registered business trust, business trust or real estate investment trust) will trigger an obligation under rule 14 of the Takeover Code for the bidding vehicle and its concert parties to make a mandatory general offer for the rest of the shares in the target public company. Effective control of a public company is acquired if the aggregate shares acquired would result in the bidding vehicle and its concert parties holding 30 per cent or more of the voting rights of such company. If the bidding vehicle and its concert parties already hold not less than 30 per cent but not more than 50 per cent of the voting rights of a public company prior to such acquisition, any increase of 1 per cent of the voting rights of such company in any six-month period will trigger the obligation to make a mandatory general offer under rule 14 of the Takeover Code. Acquisition of options and derivatives in a public company which causes the bidding vehicle to have a long economic exposure to changes in the price of securities of the public company will normally be treated as an acquisition of such securities. If the bidding vehicle and its concert parties will breach the thresholds under rule 14 of the Takeover Code as a result of acquiring such options or derivatives, or acquiring securities underlying options or derivatives when already holding such options or derivatives, they must consult the SIC beforehand to determine if an offer is required, and, if so, the terms of such offer.

A mandatory general offer must not be subject to any condition other than that acceptances received pursuant to the offer will result in the bidding vehicle and its concert parties holding more than 50 per cent of the voting rights. In addition, the offer price for a mandatory offer must be at least the highest price paid by the bidding vehicle (or any of its concert parties) for such shares during the offer period and within six months prior to its commencement.

A voluntary general offer, on the other hand, must be conditional upon a level of acceptance exceeding 50 per cent of the total voting rights unless the bidding vehicle and its concert parties already hold more than 50 per cent of the total voting rights, in which case the voluntary general offer can be unconditional. If the intention of the bidding vehicle is to privatise the company, it will usually make the voluntary

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offer subject to the receipt of acceptances of not less than 90 per cent of the relevant total number of shares within four months from the commencement of the offer, so as to entitle it to invoke the compulsory acquisition procedure under section 215 of the Companies Act to squeeze out the remaining non-accepting shareholders after the close of the offer. In this respect, it should be noted that in calculating whether the 90 per cent threshold has been reached, shares acquired by the acquirer, its related company, or a nominee of such acquirer or its related company before the general offer cannot be counted, while shares subject to an irrevocable undertaking by the shareholders of the target company to be tendered into the general offer can be counted. The SIC does not usually allow a voluntary offer to be subject to conditions that require subjective judgments by the acquirer. The offer price must be at least the highest price paid by the acquirer (or any of its concert parties) for such shares during the offer period and within three months prior to its commencement.

Some private equity firms prefer to privatise a public company by way of a scheme of arrangement under section 210 of the Companies Act because of its assurance of a binary 'all or nothing' outcome. A scheme of arrangement that is approved by a majority in numbers of the shareholders present and voting at each statutory scheme meeting representing at least 75 per cent in value of the shares voted will, if sanctioned by the High Court, be binding on all shareholders. The 3 January 2016 amendments to the Companies Act make it possible for a section 210 scheme of arrangement to be binding on holders of options and convertibles instead of having to exercise their options or convertibles before being able to participate in a scheme. However, it should also be noted that as a condition for granting exemptions from complying with certain rules of the Takeover Code, the SIC typically requires the bidding vehicle and its concert parties as well as common substantial shareholders of the bidding vehicle and the public company to abstain from voting at the statutory scheme meeting.

With regard to private companies, the relevant requirements or restrictions typically arise from the Constitution of the companies or the shareholders' arrangements between the existing shareholders. The Constitution or shareholders' agreements relating to private companies usually confer upon the shareholders (or certain shareholders) pre-emption rights in the event of a transfer of shares by an existing shareholder to a third party. In addition, the presence of tag-along or drag-along provisions in the shareholders' agreements may mean that a bidding vehicle may find itself having to acquire a larger than originally contemplated equity stake. One of the most common considerations in the acquisition of control of a private company is the ability to obtain the necessary consents and waivers from third party customers, suppliers, landlords or financiers where change in control provisions are found in the relevant contracts.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

In recent years, private equity investors continue to show a preference to sell their portfolio holdings to a strategic buyer, rather than take their chances on a public offering. Private negotiations with a strategic buyer offer vendors a greater level of control. However, both exit methods carry with them different types of challenges. In the case of a trade sale, finding buyers can be difficult in view of the current macro-economic climate where buyers continue to be prudent. In addition, the ability of a private equity firm to give commercial warranties about the portfolio company, its business, assets or liabilities in the purchase agreement is typically limited owing to a lack of direct management involvement in the business of the company; if not because of the general reluctance of private equity players to do so in a bid to limit post-closing recourse, as will be further discussed below. A trade buyer will usually also require certain consents in respect of the proposed sale to be obtained from third-party vendors of the portfolio company, and that key management personnel be retained post-sale, so as to ensure minimal disruption to the business of the portfolio company after the completion of the sale. In the case of an IPO, the main challenge, apart from pricing and book-building issues, is that the listing exercise can be a rigorous process that entails a significant diversion of management resources from the business operations of the portfolio company.

In connection with a sale of a portfolio company, private equity vendors typically insist that they give only minimal operational warranties about the portfolio company itself, its business, assets or liabilities, so as to limit the possibility of any post-closing recourse. Generally, buyers will reluctantly accept this condition, and where the management of the portfolio company is selling their stake as part of the trade sale, the focus inevitably falls on them. If the management sellers have a significant stake in the portfolio company, warranties from those management sellers may offer a material degree of comfort to the buyer. However, if the management sellers own a relatively small stake, such warranties given by them are unlikely to be sufficient from a buyer's perspective as the liability exposure of such management personnel is unlikely to be higher than the proceeds for the management stake. A compromise that is gaining popularity in Singapore is the use of W&I insurance, which, in some circumstances, is employed to give comfort to a buyer for that part of the value of the sale proceeds not covered as a result of the private equity vendors not providing operational warranties.

To the extent that private equity vendors are required by the buyer to take on the risk in the purchase agreement for specific liabilities or risks identified during due diligence, indemnity provisions tightly crafted around specific liabilities or risks are preferred over the giving of open-ended warranties. It is not unusual for buyers to require that a portion of the purchase consideration be set aside in an escrow account for the duration of the claim period stipulated in the purchase agreement, although this will limit the ability of the private equity vendor to distribute the purchase proceeds to its investors and to liquidate the special purpose vehicle that previously held the relevant equity stake. In this regard, there has been an increasing trend in recent times to explore W&I insurance to bridge impasses in deal negotiations as it offers parties a third-party alternative in the risk allocation process. A sell-side W&I insurance policy for the vendor would typically provide cover for the vendor's liability in the event of a claim under an indemnity provision or arising out of a breach of a warranty, after application of the policy excess. From a liability perspective, the vendor remains liable to the buyer under the purchase agreement but the vendor will bring in the insurers in the event of a relevant claim being made by the buyer. A buy-side W&I insurance policy allows the buyer to recover losses from warranty and indemnity claims directly from the insurer, plugging the gap in a buyer's inability to recover under the warranties or indemnity provisions under the purchase agreement, whether as a result of the negotiated cap on the vendor's liability or the vendor's inability to meet any claims.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Typically, for a listing on the SGX, rights and restrictions set out in a shareholders' agreement will terminate upon an IPO together with the initial shareholders' agreement. This is particularly the case as shareholders are likely to be regarded as parties acting in concert with each other under the Takeover Code if the shareholders' agreement continues to be in effect. Thereafter, the 2012 Code will provide guidance on the standard of corporate governance to be maintained by companies listed in Singapore. For example, principle 4 of the 2012 Code states that '[t]here should be a formal and transparent process for the appointment and re-appointment of directors to the Board.' Guideline 4.1 of the 2012 Code further provides that the board should establish a nominating committee to make recommendations to the board on all board appointments, with written terms of reference clearly setting out its authority and duties.

Registration rights are generally not required for post-IPO sales of shares on the SGX.

In the case of SGX Mainboard companies that satisfy the profitability test, the promoters' entire shareholdings at the time of listing will be subject to a lock-up restriction of at least six months after listing. In the case of SGX Mainboard companies that satisfy the market capitalisation

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test or SGX Catalist companies, the promoters' entire shareholdings at the time of listing will be subject to a lock-up restriction of at least six months after listing, and at least 50 per cent of the original shareholdings (adjusted for any bonus issue or subdivision) will also be subject to a lock-up restriction for the next six months. In the case of investors each with 5 per cent or more of the company's post-invitation issued share capital and who had acquired their securities and made payment for their acquisition less than 12 months prior to the date of the listing application, a certain proportion of their shareholdings will be subject to a lock-up restriction for six months after listing. On the other hand, for investors each with less than 5 per cent of the company's post-invitation issued share capital and who had acquired their securities and made payment for their acquisition less than 12 months prior to the date of the listing application, there will be no lock-up restriction on the number of shares that may be sold as vendor shares at the time of the IPO. However, if these investors have shares that remain unsold at the time of the IPO, a proportion of such remaining shares will be subject to a lock-up restriction of six months after listing. In addition, subject to certain exceptions, investors who are connected to the issue manager for the IPO of the company's securities will also be subject to a lock-up restriction of six months after listing.

The purpose of such lock-up restrictions is to maintain the promoters' commitment to the listed company and align their interest with that of public shareholders.

Following an IPO, a private equity sponsor may dispose of its remaining shareholdings via a block sale.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Going-private transactions involving private equity sponsors are typically focused on industries where the financiers are able to obtain appropriate security arrangements to secure the financing required for the leveraged transaction. There is typically a preference for private equity sponsors to look for companies with a strong cash flow and a strong management team that is prepared to continue post-completion. Companies with the ability to reduce expenses and with less leverage are also attractive buyout candidates as there is greater opportunity to realise the value in the leveraged buyout.

Notable going-private deals in 2017 include the proposed acquisition and privatisation of Global Logistic Properties Limited by Nesta Investment Holdings Limited (which is controlled by a consortium comprising various investors including HOPU Logistics Investment Management Co, Ltd, Hillhouse Capital Logistics Management, Ltd, Bank of China Group Investment Limited and Vanke Real Estate (Hong Kong) Company Limited) by way of a scheme of arrangement in what will be Asia's largest ever private equity buyout, the privatisation of Croesus Retail Trust by Blackstone by way of a trust scheme (being the first time a privatisation has been done via this method), as well as the sale by the Farallon Group of its units in Indiabulls Properties Investment Trust into an offer by Brenformexa.

Other private equity deals in Singapore (apart from going-private transactions) typically involved companies in various industries as with previous years. Some of the more notable transactions include the US$500 million fundraising round by Traveloka Holding Limited from Expedia Inc, East Ventures, Hillhouse Capital Group, JD.com and Sequoia Capital, the proposed strategic partnership between NTUC Income and Fullerton Fund Management Company Ltd (a wholly owned subsidiary of Temasek Holdings) to appoint Fullerton as the investment manager of a portfolio of NTUC Income assets estimated at S$23 billion, and the US$100 million investment by Proterra Investment Partners for a stake in FKS Food and Agri Pte Ltd.

Certain industries are strictly regulated and the acquisition of shares above a certain threshold in these industries requires approval from the relevant governmental agency or regulator. Examples of such restricted industries include banking, broadcasting and newspaper publications. Accordingly, private equity firms may find it more difficult to take companies in these industries private. Investments in these companies may also require the cooperation of one or more co-investors.

Update and trends

Deal flow in relation to private equity transactions was robust in 2017, with a particular industry focus by bulge bracket funds on the real estate sector. As with previous years, growing interest from mainstream private equity firms in what has typically been the venture capital space has increased competition and driven up prices, resulting in venture capital and growth capital investors having to adjust in order to secure sound investments or value-add to their existing portfolio. The Singapore government has continued to be supportive and facilitative of private equity transactions, particularly in the start-up and fintech sectors (the MAS has built on the success of the inaugural Singapore FinTech Festival held in 2016 and organised the second Singapore FinTech Festival in November 2017, in what has become the world's largest fintech festival, further burnishing Singapore's credentials as a fintech and venture capital hub).

Separately, merger control regulations could also potentially limit the ability of a private equity firm to acquire a Singapore company if that firm has an interest in another major competitor in the same industry.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Tax-related considerations tend to shape the deal structure on a cross-border going-private or private equity transaction as parties seek to minimise the tax costs of the acquisition as well as tax leakages in the existing operations. Specifically, the impact of withholding taxes on dividends, local taxes, distributions and interest payments and restrictions on the private equity sponsor's ability to repatriate earnings should be taken into account when structuring such cross-border transactions.

The ability of a private equity fund to implement a leveraged transaction may be limited by foreign laws prohibiting companies in their respective jurisdictions from providing financial assistance in the form of security arrangements or guarantees. These limitations may compel the private equity fund to procure separate bank financing at the operating company level (rather than at the bidding vehicle level) to provide the lenders with an acceptable security arrangement to support the credit assessment.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

The members of a club or group deal should be mindful of changes in the shareholdings of the members of the group. While the SIC accepts that the concept of persons acting in concert recognises a group as being the equivalent of a single person, the membership of such groups and the shareholding of the members in the target company may change at any time. As such, there will be circumstances where the acquisition of voting rights by one member of a group acting in concert from another member or other non-members will result in the acquirer of the voting rights triggering a mandatory offer obligation. In situations like these, the SIC should be consulted in advance.

Participants in a club deal should also be mindful that their conduct in the club or group deal is not regarded as anticompetitive under local competition regulations. Appropriate documentation should be executed between the parties to deal with decision-making procedures, sharing of information, funding commitments and obligations, termination events, exit strategies, confidentiality obligations and dispute resolution mechanisms.

While the compulsory acquisition rules under section 215 of the Companies Act previously only allowed a single legal entity to exercise the squeeze-out rights, since 3 January 2016, amendments to the Companies Act have come into force that allow two or more persons who act as joint offerors to exercise the compulsory acquisition rights.

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20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

It is common for a private equity buyer to seek to have in place closing conditions that enable it to walk away from a deal without penalty should certain prescribed events occur prior to closing or if the necessary approvals and waivers cannot be obtained. Common conditions to closing include material adverse change (MAC) clauses, under which the private equity buyer will be allowed to terminate the transaction in the event of a MAC to the target's overall business, assets, financial condition or results of operations.

In addition, a private equity buyer will typically insist on the inclusion of certain pre-closing covenants to exercise a certain level of control over the target prior to the private equity buyer assuming control. MAC clauses and 'best efforts' covenants are not new and are often the subject of long negotiations between the vendor and the private equity buyer. Certainty of closing will be compromised if such MAC clauses or best efforts covenants are not drafted in precise or quantifiable terms, allowing the vendor to subsequently rely on the vagueness or subjectivity of the language to terminate the transaction without penalty.

To improve deal certainty, parties may try to discourage any walk-out by agreeing up-front on a break fee payable in the event the transaction is aborted because of certain specified events that have the effect of preventing the transaction from proceeding or causing it to fail (for example, where a superior competing offer becomes or is declared unconditional as to acceptances within a specified timing or the recommendation by the target board company of a higher competing offer). However, in cases where the Takeover Code applies, certain obligations and restrictions would apply to break fee arrangements, such as the requirement for any break fee to be kept minimal, usually no more than 1 per cent of the transaction value.

The private equity buyer may also impose on the vendor exclusivity restrictions for a specified period in the purchase agreement with the aim of preventing the vendor from soliciting competing bids or putting an end to ongoing talks with other interested bidders. However, it should be noted that the Takeover Code mandates equality of treatment of competing offerors. Any information provided to one bidding vehicle must be provided equally and promptly to any other bona fide offeror.

Where shareholders' approval for the sale is required, the private equity buyer may seek irrevocable undertakings from certain existing shareholders (usually members of management or a substantial shareholder, or both) to increase its chances of obtaining sufficient votes for the approval. In the context of going-private transactions, as highlighted above, the bidding vehicle's financial adviser is usually obliged to provide a written confirmation as to the sufficiency of financial resources available to the bidding vehicle to complete the acquisition. To minimise the risk of payment default, in some cases such confirmation is provided at the bid submission stage to provide comfort to the vendor as to the certainty of closing.

To avoid prolonged uncertainty, it is also common for purchase agreements to stipulate a long-stop date before which all conditions to closing must be fulfilled.

It should be noted that in a going-private transaction subject to the Takeover Code, the termination of the purchase agreement is subject to the SIC's approval being obtained even where the condition giving rise to the termination right has been triggered.

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Sweden

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

The Swedish private equity (PE) market remains active and the amount of PE transactions involving Swedish targets or Swedish PE fund managers (or both) continues to be high. The Swedish PE market is considered strong and is one of the largest in Europe (measured in terms of its share of GDP). Buyers and sellers are quite accustomed to private equity sponsors and their concerns, which facilitates deal execution and structuring.

Infrastructure-related deals have traditionally been frequent on the Swedish PE transaction market. In respect of the number of PE transactions, the wholesale and retail, consumer goods, financial institutions and technology (internet-based services, fintech, medtech, biotech and gaming) sectors have also dominated the Swedish market.

A majority of the Swedish PE players focus on mid-cap target companies. In general, target companies are exited through trade sales, secondary buyouts and IPOs. In recent times most of the established Swedish PE funds have quite mature portfolios, which are currently exited through IPOs owing to the high valuations present on the Swedish stock exchanges.

Controlled auctions are still quite commonly used regarding PE transactions involving non-public target companies. However, owing to the fierce competition for Swedish target companies, PE players continue to focus heavily on approaching target companies at a very early stage to conduct bilateral, exclusive negotiations.

PE transactions involving large-cap and mid-cap targets are often executed by PE funds organised as a limited partnership, wherein the institutional investors participate as direct or (normally) indirect limited partners, and wherein the fund manager acts as the general partner, normally owned through a private limited liability company specifically organised for this purpose. The domicile, tax status and internal structure of the manager sponsoring the fund will drive the choice of structure of the general partner. The acquisition of shares in a Swedish target company will be made by a foreign or domestic holding structure through a Swedish-incorporated and tax-resident special purpose vehicle (SPV or BidCo). Additional holding companies could be added to the structure to allow for flexibility in obtaining subordinated debt financing and for other tax and commercial reasons.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The Swedish Corporate Governance Board is an association that issues guidelines and best practices for the Swedish stock market. The Swedish Corporate Governance Code (the Code) sets out rules applicable to companies listed on a regulated market, under the principle of 'comply or explain'. Several of the rules in the Code seek to improve transparency within public companies, by, for example, prescribing a certain composition of independent directors of the board and the requirement to annually publish a corporate governance report. The measures needed to be taken under the Code, from the moment of going public on a regulated market, impose additional costs and administrative burden on companies and their boards of directors. Although the Code may be applied on non-regulated markets, the use of the Code would not be of any significant value for a private company with a limited number of shareholders and low share float. Thus, going private would save costs and untie the prescribed board composition in this respect.

The governance arrangements commonly used by PE funds to gain management control over their portfolio companies tend to be relatively detailed, but we may see substantial variations between domestic funds compared to the governance structure deployed by European or global PE funds. It is a common strategy to influence and steer the portfolio companies by appointing directors of the board. There would be a limited availability to do so for a company listed on a regulated market, owing to the Code. Although the Code is possible to deviate from by explanation, deviations related to board composition are not well received by the market and regulators, making them very hard to justify in practice. Such portfolio company often has to elect a new, or amended, board of directors prior to going public, in order to be approved for listing at all.

Further, the public environment is generally full of market rules on transparency, besides the Code. By going private, thus lifting the stock off a marketplace, the company will avoid the requirements of press releasing price-sensitive events and publish information on holdings in the future. This may in itself be a reason to take the company private.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Takeover bids are regulated under the Swedish Stock Market (Takeover Bids) Act. The Swedish Financial Supervisory Authority and the regulated market places monitor companies' compliance with the regulation, which comprises of both the Takeover Bids Act and the more detailed takeover rules as set out by the Swedish Corporate Governance Board and the regulated market places (Nasdaq Stockholm and NGM Equity). The Swedish Securities Council may upon request provide guidance on interpreting the takeover rules and grant exceptions from the rules in specific cases.

The board of directors of the target company is prohibited from taking defensive actions without the support of the general meeting in connection with a takeover bid. Such actions involve measures taken in order to obstruct the bidder from acquiring the shares, such as pursuing a share repurchasing or a reversed offering to the bidder's shareholders. However, the board of directors is generally not prohibited from screening for other bidders. A potential bidder will quite often find it challenging to successfully conclude a take-private transaction

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by launching a public bid without the cooperation and positive recommendation of the target's board of directors since, as a rule, parts of the process and the requests from the bidder is under the discretion of the target company's board of directors, such as the decision to allow or restrict the scope of a due diligence process of the target company or allowing certain bonus packages targeting employees of the target company to be offered. Consequently, one of the bidder's main hurdles in such public deals is obtaining access to due diligence. Provided that the target's board is prepared to recommend such an offer, the bidder will normally be admitted to a confirmatory due diligence of the target. It is therefore not surprising that a prospective acquirer (particularly PE funds) will almost always seek the upfront recommendation of the target board.

When the board of a listed company reviews a going-private proposal, the board must ensure to satisfy their fiduciary duties. The board of directors must prepare a report evaluating the company effects of the bid and present the board's view of the bid and the reasoning thereof to the shareholders. The report shall include the board's view on the consequences for the business and business strategy, the employment and the regions where business is conducted.

All directors of a listed company considering entering into a going-private transaction also must assess if and to what extent they can and should assist in the transaction, or if they have a conflict of interest. If a director in the target company has a specific interest in a potential bidder or in a bidder in competition of a first bidder, such director will become incompetent, and must not participate in the handling of an issue relating to the bid.

Further, if a director of the board, an employee of the management or a closely related party to such person of the target company participates in the bid, the board of directors shall obtain an independent valuation report in order to mitigate the bidder's information advantage, compared to the shareholders' general and perhaps limited information, related to the company value. The duty to obtain a valuation report is terminated if an independent third party provides a second bid on the target company, which is then functioning as a relative benchmark.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

A takeover of a publicly listed company under Swedish law is more extensively regulated than takeovers of private companies. Both the prospective buyer of listed targets and the targets' boards will have to observe a detailed set of rules and regulations that govern these types of transactions. These rules comprise, among others, insider dealings rules, mandatory offer thresholds, disclosure obligations with regard to ownership of shares and other financial instruments, limitations on the content of the offer documents, filing and regulatory approval of the offer documents, the length of the offer periods, employee consultations, limitations on type of consideration offered, etc.

In principle, there are several avenues of approach for PE houses desirous to taking a publicly listed company private under Swedish law – one of which is to launch a voluntary tender offer to the shareholders. The principal rules regulating takeovers of publicly listed companies is found in takeover rules as set out by the Swedish Corporate Governance Board and the regulated market places (eg, Nasdaq Stockholm). One of the beneficial features with a voluntary offer is that, in general, there are no limitations in law as to which conditions such an offer may contain as long as it can be determined whether they are fulfilled or not; this affords the PE fund a great deal of flexibility (eg, with respect to price, type of consideration and required conditions precedents). A voluntary tender offer may be launched at the bidder's discretion as soon as it has sent notice to the relevant stock exchange that it undertakes to comply with the stock exchange's regulations for takeover bids and to accept the sanctions that the stock exchange is allowed to decide on in the event of breaches to these regulations. The bidder can also choose to make the offer to only some of the shareholders. Additionally, the offers are conditional on more than 90 per cent of the shareholders tendering their shares since minority squeeze-out rules make it efficient to acquire the remaining shares. A voluntary offer can also be made subject to a financing condition, although this is rare.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

In a PE transaction relating to a private company under Swedish law, there is no fixed timetable. Except for competition clearance and sector-specific rules (eg, regarding financial institutions), corporate transactions in general do not require consent from Swedish authorities, hence regular share purchases can be completed in accordance with the time schedule agreed upon by the parties. However, standard waiting periods pursuant to relevant competition legislation will, of course, apply. The major issues affecting the timetable for private transactions in Sweden are as follows:

- the initial due diligence exercise that the purchaser intends to undertake;
- in the event that it is necessary to file the transaction with domestic or foreign competition authorities, the time required to prepare the necessary merger filing. In respect of a Swedish merger filing, a standstill obligation applies until the Swedish Competition Authority has cleared the transaction. After receipt of the filing, the Swedish Competition Authority has up to 25 working days to make its initial assessment of the proposed transaction;
- timing of and speed of work stream for financing discussions. The time required for such discussions will normally be heavily dependent upon the complexity and size of the deal;
- timing necessary for implementing relevant co-investment arrangements with investing management;
- timing necessary to establish the desired investment vehicles and special purpose vehicles in order to execute and complete the contemplated transaction; and
- if the target company is operating within certain industries or sectors, there may be specific requirements to consider (such as requirements for public permits and approvals). Such industries are, for example, banking, insurance, petroleum, hydropower, media, infrastructure and telecoms.

The issues influencing the timetable for going-private transactions in Sweden will, in general, be similar to those above. However, the following additional issues must be taken into account:

- the time necessary to prepare and receive approval of the offer document;
- the time necessary for the target's board to evaluate the offer and any alternatives;
- in a voluntary tender offer, the offer period must be no less than two weeks and no more than 10 weeks, and in a mandatory offer, the period must be at least four weeks and no more than six weeks;
- the time necessary to conduct squeeze-out of the minority shareholders; and
- the application process for delisting the target in the event that the bidder has not managed to acquire more than 90 per cent of the shares and some of the remaining shareholders file an objection against delisting the target company.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

When a company decides to suggest its shareholders take the company from public to private, the general meeting will have to resolve upon the matter. The resolution is valid if all shareholders present at the general meeting vote for the decision and that they together represent at least nine-tenths of all shares in the company. As a consequence of the above, 10 per cent or more of the votes can challenge a transaction.

To address the risks associated with shareholder dissent, the acquirer prepares and structures the transaction accordingly. Firstly, the acquirer may seek the pre-approval by the target's board of directors for their recommendation to its shareholders and further secure conditional or unconditional acceptances from major shareholders of the target company. The target company may not enter into agreements with the acquirer, involving restrictions on competing bids or break-up fees, without a prior approval from the Swedish Securities Council. The approval has to be applied for in a certain course of action

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and may only be obtained under certain conditions, one of which is that the prospect of a bid is of benefit to the shareholders. Secondly, due preparations with respect to due diligence of the target company and preparations with respect to financing and other key conditions are conducted to mitigate the risk of revaluing or declining the offer.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Strategic players and PE players employ quite similar purchase agreement provisions on the Swedish market. The purchase agreement is usually adapted heavily to the business of the target companies and the type and leverage of the seller.

The main focus areas include calculation and payment of the purchase price, closing conditions, warranties and restrictive covenants. It should be noted that warranty and indemnity (W&I) insurance is increasingly common in the Swedish PE market, bridging gaps between the seller and the buyer.

It is common to see that the PE bidder will have to prove to the seller that financing of the purchase price is obtained through confirmation from the proposed debt provider prior to entering into a purchase agreement. Further, the bidder normally provides the seller with an equity commitment letter guaranteeing that drawdown of sufficient equity from the fund or the fund's investors will be done to cover the remaining part of the purchase price due by BidCo not covered by the debt provider. The financing package is normally in place at the time of signing.

Regarding both PE buyers and sellers, a 'locked box' purchase price mechanism is preferred. The locked box mechanism is generally preferred as it offers certainty in the purchase price, avoids post-closing adjustments and potential disputes in relation thereto, and enables prompt distribution of sale proceeds to investors and sellers after closing. When a locked box mechanism is used, it is common that an interest component is introduced calculated from the locked box date, depending on the type of business, corresponding to, for example, the cash flow generated by the business. Depending on the seller, it is not uncommon that part of the purchase price is paid as consideration shares in the SPV, or part of the purchase price is financed by the seller through a vendor loan note.

Deal certainty is a decisive factor for PE players, and conditions precedents are in general kept to a minimum. The closing conditions most commonly seen are merger control clearance (if applicable), often implying heavy obligations on the buyer to obtain approval, and other sector-specific clearances and deal-specific requirements (such as the mitigation of issues discovered in the due diligence process).

A PE seller (at least in higher ranges of mid- and large-cap or highly competitive processes) usually only provides fundamental warranties such as title, capacity and authority and absence of certain events warranties (ordinary course), unless the liability is insured under a W&I insurance policy. Management might provide more extensive warranties than the PE seller, but usually all sellers are treated equally in the purchase agreement, mainly because of customary drag provisions under the sellers' shareholders' agreement where equal treatment is normally a general rule. There are several standard limitations to the warranties, including baskets and caps, exclusion of tax deductible items and exclusions for information provided during the due diligence process. A typical trend is, especially where the seller is a PE fund, extensive limitation of liability, facilitating clean exits as far as possible.

Finally, restrictive covenants including restrictions on how the business is run between signing and closing and non-competition/non-solicitation covenants of two to five years following the transaction are common, however this depends heavily on the type and leverage of the seller.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

How the managers and directors of the target company can participate is subject to the rules set out in questions 3 and 4. It is important that the board may not act in its own interests or allow itself to be directed by the interests of only one or some shareholders. However, a PE investor may (after seeking the approval of the board) discuss compensation, bonus and similar arrangements with the senior management prior to making its offer public. A determination of whether such approval should be given must be made based on the obligation to act in the interests of shareholders. The discussions then need to be disclosed when the offer is made public.

The compensation arrangement provided by PE investors typically includes management incentives shares in the SPV used to make the offer. The incentive shares are used to align the interests of management with the interests of the investor. Tax issues for this sort of compensation typically need to be addressed. Further, normally strong transfer restrictions apply through a shareholders' agreement. The management typically need to sell back their shares should they wish to leave their employment through good-leaver and bad-leaver provisions; and drag-along and tag-along provisions are present to enable a smooth exit process.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The vast majority of transactions on the Swedish PE market are conducted through share deals as a share deal is normally tax-exempt for the seller under the Swedish participation exemption rules. When acquiring a Swedish limited liability company the buyer assumes the historical tax risks related to the acquired company. The reassessment period in Sweden is six years following the fiscal year-end, meaning that tax issues for the fiscal year (FY) 2011 onwards (not openly disclosed) can generally be reassessed by the Swedish tax agency until 2017. The type of tax risks depends on the business conducted by the target company.

When establishing the acquisition structure the following tax issues should, for example, be considered:

- financing structure: to the extent that interest deductibility is achieved (see below), it can be possible to allow for the taxable income of the Swedish target group to be offset against interest payments related to the acquisition. Therefore, a Swedish acquisition company may be established. Provided the acquisition company holds more than 90 per cent of the shares in the target company, tax consolidation may be achieved by way of group contributions as of the year after the year of acquisition. Measures may, however, be considered to establish consideration sooner (eg, a merger or change of FY);
- repatriation of funds: there is no withholding tax on interest payments. Dividends from a Swedish company to an EU-resident parent company are normally exempt from withholding tax. However, should the beneficial owner of the dividend be a non-EU company, the amendments to the EU Parent or Subsidiary Directive regarding anti-abuse should be further analysed; and
- tax-optimised exit structure: under the Swedish participation exemption rules, a Swedish holding company can generally sell the shares in a Swedish wholly owned and unlisted subsidiary tax-exempt without any holding requirements.

It should be noted that there are no formal debt-equity rules, thin capitalisation rules or earning stripping rules in the Swedish tax system. Interest payments on external loans have historically been fully

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deductible in Sweden, and in 2017 the Swedish Ministry of Finance presented its proposal on how Sweden will adapt its legislation regarding interest deductions in line with the EU Anti-Tax Avoidance Directive of 12 July 2016. The government primarily proposes a general limitation of interest deductions in the corporate sector primarily as an earnings before interest and tax (EBIT) rule (where the cap for deduction is calculated as 35 per cent of EBIT) and, secondarily, as an earnings before interest, tax, depreciation and amortisation (EBITDA) rule (where the cap for deduction is calculated as 25 per cent of EBITDA). The proposal is now subject to consultation and the rules are expected to enter into force in July 2018.

The current Swedish interest deduction limitation rules for intra-group loans are fairly complex and the interpretation of the rules is not clear. It is worth mentioning that, according to the main rule, interest payments on all loans between affiliated companies are non-deductible. There are also special rules if the lender is a company subject to yield tax. In typical limited partnership-based PE-structures, these rules mean that no deduction is allowed for interest payments on shareholder loans granted by the fund. Albeit uncertainty arguably exists, potentially also interest deductions relating to loans granted directly by the fund or the investors in the PE-funds may be denied. In connection with the proposal referred to above, the existing interest deduction limitation rules are proposed to remain in place but are amended and provide that interest is not deductible where the debt relationship has been entered into 'exclusively or as good as exclusively' for the group to obtain a significant tax benefit. Deductibility also requires that the lender:

- is resident within the EEA;
- is resident in a country with which Sweden has a double tax agreement; or
- is subject to tax of at least 10 per cent.

Dividend payments on stocks (common stocks or preferred stocks) are not deductible for Swedish limited liability companies (there are exceptions for companies classified as investment companies and certain associations).

As a general rule, all types of salaries and benefits paid to an employee should be considered an employment income taxed with progressive tax rates. Salary costs are also subject to social security contributions for the employer, which is a deductible cost for the employer.

Generally, management incentive programmes in Swedish target companies are structured so that management is offered the opportunity to invest in the fund or target companies through an instrument that will qualify as a security for Swedish tax purposes (shares, warrants, convertible bonds, profit participation loans). In order to reduce the initial investment, management may be offered to invest in the highly debt-financed acquisition company. An alternative may be to issue warrants or to use different types of share classes. In order to avoid a tax exposure it is important to make a third-party valuation of the instruments offered to management and to ensure that the instruments are not subject to severe restrictions.

Share acquisitions are in general not classified as asset acquisitions for tax purposes. One exception worth mentioning is that Sweden has controlled foreign corporation rules stating that a foreign company registered in a low-tax jurisdiction owned by a Swedish company or Swedish individual should be disregarded for tax purposes meaning that the Swedish company or individual for tax purposes are considered holding the assets of the foreign company directly.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

The typical debt financing of a going-private or PE transaction in the Swedish market combines (two or more of) subordinated debt that is treated as equity for ranking and covenant purposes, mezzanine or high-yield bond debt and senior bank loans. The concept of second lien is rarely seen in the Swedish market. Mezzanine debt is not as commonly used as it was pre-crisis, whereas the market for high-yield bonds has seen a significant development in the past few years.

Typically, existing indebtedness in a target group will be refinanced on the closing of an acquisition. Timing issues may arise in relation to prepayment notices, where the target's management is hesitant to send a binding notice of prepayment to the incumbent bank group before they are completely certain that new funds will be available on closing. Commercial and timing issues may also arise in relation to prepayment or breakage costs.

Swedish law contains financial assistance rules that prohibit the making of loans or granting of security or guarantees with the purpose of financing an acquisition of shares in the lender or grantor itself or its parent or sister company. There is no whitewash procedure under Swedish law; however, the prohibition on financial assistance is not perpetually linked to a certain loan (differing from, for example, Norwegian law). Therefore, a target company or its subsidiaries cannot provide cash loans, security or guarantees in direct relation to an acquisition of said target. However, the target group may provide security and guarantees after a period of time; subject to certain other caveats regularly advised on by practitioners.

The granting of security and guarantees by a target or subsidiary under Swedish law is further subject to general company law restrictions on distributions, certain prohibited loans and the purpose of a company's business. Whether and to what extent such restrictions apply, and how they are dealt with, requires analysis on a case-by-case basis. Generally, however, a limitation language to address these issues is inserted in any relevant security or guarantee document.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

In a going-private transaction, the bidder may include a financing condition in its offer. However, such condition may not relate to equity financing and could effectively only be invoked should the financing banks fail to fulfil their obligations under the relevant loan agreement. The debt financing for a takeover bid therefore typically includes 'certain funds' language, meaning that the lenders may not refuse to make available acquisition facilities unless a default occurs because of circumstances within the bidder's control. Debt facilities will be negotiated and either a full loan agreement or a short-form loan agreement (enough for the banks to fund their participations but intended to be replaced by a fully negotiated agreement in time for completion) will typically be signed prior to submitting a binding offer.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

The Swedish financial assistance regulations prohibit a target company from granting loans or in other ways providing assets to enable a third party in acquiring the target company's shares. These restrictions decrease the risk of creditors being defrauded which leaves fraudulent conveyance issues uncommon. Fraudulent conveyance issues and bankruptcy issues are also handled by warranties and representations made by the seller in the purchase agreement, stating that the target company is not insolvent or that insolvency proceedings or similar proceedings have not been started or threatened.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements are deemed standard documentation to regulate business strategy and protect investments in practically all joint investments involving financial players such as PE funds. To ensure foreseeability or to enable the value creation of, for example, the sponsor or the management, the agreement typically contains provisions on corporate governance issues, refinancing and exit, share transfer

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Update and trends

In 2017 the Swedish PE market remained stable and heavily focused on the mid-cap segment – where domestic fund managers are experienced and the availability of targets in need of growth capital is high. On the fundraising side, notable events during 2017 include the final close of EQT's €4 billion third infrastructure fund, EQT's €1.6 billion Mid-Market Europe Fund as well as Adelis Equity Partners' second fund of €600 million.

2017 saw a continued strong deal flow in the Swedish tech sector, and specifically the vibrant fintech sector, with a significant investment by Permira into Klarna (backed by Sequoia Capital and Atomico) and iZettle. From the European perspective, Sweden is among the four countries which attracted the highest investment to the fintech sector, both in terms of number of deals and dollar investments. The sector also saw a spectacular large-cap deal when Nordic Capital sold its payment services portfolio company Bambora to French Ingenico Group for €1.5 billion.

Both foreign and domestic PE funds continue to divest their mature Swedish portfolios, and exits through IPOs continue to be an attractive approach. Among the notable PE fund IPO divestments in 2017 are Triton/KKR's divestment of Ambea (healthcare), the IK Investment Partner-led IPO of Actic Group (fitness), FSN's IPO of Instalco (industrial services), Nordic Capital's IPOs of Munters (air treatment and climate control) and Handicare international (medtech) and Segulah's divestment of its holding in Balco (construction).

The Swedish PE community continues to be affected by the tax authorities' continuous scrutiny of PE structures and the taxation of owners in PE management companies. In April 2017, the Administrative Court of Appeal delivered 85 judgments against PE employees of the leading Swedish management companies Altor, EQT, IK Investment, Litorina, Nordic Capital and Triton, ruling in favour of the Swedish Tax Agency and holding that the returns or profits on capital received by the employees should be treated as income from services according to rules that apply to companies instead of being taxed as capital gains. The judgments have been appealed to the Supreme Administrative Court.

2017 also saw the publication of the final report by the government commission calling for a cap on profits for all private companies operating in the education and welfare sectors funded by tax money, which continues to cast a pall over the willingness to invest in the sector.

restrictions and specific sanctions. From a governance perspective, an important requirement for the sponsor is to ensure that the shareholders' agreement provides the sponsor with continuous access to updated information about the company.

The ability to appoint directors, and to control the board if necessary, is one of the most important tools for a sponsor. It is not uncommon, though, that some PE funds want to appoint an independent chairman to provide strategic oversight and create an independent bridge between the sponsor and the investing management, and some international funds may also want to implement a separate management board. The sponsor-appointed directors will usually have control over important decisions through veto rights or preferential voting rights vested in them through the shareholders' agreement (or both); such decisions typically being new acquisitions and disposals, approval of the business plan and annual budgets, new investments outside of the business plan, etc, as well as provisions about appointment and dismissal of directors (always subject to consent from the general meeting, often meaning the sponsor itself), as well as audit and remuneration, transfer and issue of shares and financial instruments. Other typical provisions include confidentiality and other restrictive covenants, management of an exit process, and customary drag-, tag- and shot-out provisions. Some sponsors may divide the list of vetoes between those requiring director consent and those that require the consent from the sponsor itself at shareholder level.

It has been increasingly common to include a detailed set of protective provisions in Swedish portfolio companies' articles of associations. Traditionally, most domestic PE funds have preferred to keep these types of provisions in the shareholders' agreements for confidentiality and flexibility reasons. For the past few years, it has nonetheless become more common to also include certain protective provisions in the articles, especially if the portfolio company is controlled by an international PE fund.

It is important to note that neither the board (as a governing body) nor the CEO will be bound by veto rights in a shareholders' agreement. This means that even if a shareholders' agreement grants a director appointed by the sponsor a veto over certain important board resolutions, there will always be a risk that the board disregards such rights of veto and instead resolves the matter in question as the board's majority finds appropriate. In order to cater for the risks of disobedience by the board, one could potentially consider requesting each director to sign some form of adherence agreement to the shareholders' agreements. Such adherence would potentially be deemed unreasonable by a court since the board owes fiduciary duties to the shareholder community as a whole and the company that are above those of the shareholders appointing the respective director, unless otherwise set out in the company's articles of association. As a result, some funds seek to cater for such risk by implementing provisions in the portfolio companies' articles of association, stating that the shareholders and the company have entered into a shareholders' agreement regulating, inter alia, restrictions on the transfer of shares, veto rights, etc.

Normally, an appropriate and well-tailored enforcement mechanism in the shareholders' agreement itself will, however, in most situations, be considered sufficient to ensure that no party (in particular the directors holding shares) has any incentive to breach the terms of the shareholders' agreement, and therefore that it will not be necessary with any further enforcement. In practice, most Swedish funds seem to rely on such enforcement mechanisms in the shareholders' agreements instead of implementing lengthy articles of associations.

The term of Swedish shareholders' agreements is typically fixed (eg, for the investment horizon of the sponsor or 10 years), but automatically renewed. This is because of Swedish principles of law making it possible to terminate indefinite agreements subject to a 'reasonable' notice period.

As the vast majority of PE transactions involve acquisition of a majority stake, shareholders' agreement minority protection rarely becomes a major issue. However, the Swedish Companies Act contains varying minority protection provisions. As a general principle all shareholders should be treated equally. This means that the majority investor is prohibited to make illegal value transfers that benefit itself at the cost of other shareholders. Further, certain decisions such as new share issues that are not offered pro rata to the current investors require the support of a qualified majority. Finally, there are certain specific minority protection rules (eg, entitling the minority to appoint an additional auditor and special requirements for majority investors acting poorly to redeem the minority shares at market value).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

There is no general regulation with certain acquiring restrictions related to private equity firms. However, depending on the business acquired there may be restrictions and requirements such as capital requirements, ownership assessments and permits related to, for example, financial institutions and insurance companies.

If a public company is to be fully acquired, the regulation for public takeovers applies and sets out the rules for such process. If an acquirer, directly or indirectly, obtains 30 per cent or more of the votes for all shares in the target company, a mandatory bid requirement on the whole target company may be triggered.

Information requirements related to holdings in public companies applies as an acquirer crosses a holding of 5, 10, 15, 20, 25, 30, 50, 66 and 90 per cent of the total votes or shares of the target company. This is not a restriction itself, but a mandatory compliance regulation increasing the disclosure burden of the shareholders and the transparency of the company.

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15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

There are no general exit restrictions specific to PE investors. Selling shares is of course subject to transfer restrictions in the articles of association and shareholders' agreement concerning the target company. However, as mentioned in question 13, PE-initiated shareholders' agreements typically contain drag-along provisions that enable the PE investor (and the remainder of the owners) to exit the target company.

Since PE funds have a limited life span, the PE investors typically reject to offer extensive warranties and indemnifications as mentioned above. The strength of the parties and the state of the target company determine what warranties and indemnifications are needed. In secondary buyouts it is not uncommon that the PE investor needs to provide more warranties than in other cases. PE players typically reject to provide an escrow to cover potential claims. Therefore, especially in the Swedish mid-cap segment, the interest for W&I insurance has increased, providing clean exits and minimising time spent on negotiating the warranties. W&I insurance is typically required when PE investors are buying from company founders that will keep a minority stake in the target company. However, as mentioned above, there has also been an increase in the use of insurance when the PE investor itself exits a portfolio company because of the mature Swedish W&I insurance market (offering reasonable pricing for extensive insurance coverage).

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

The starting point related to the shares in a going public transaction is to dissolve all rights and restrictions related to the shares, including internal restrictions such as within a shareholders' agreement and external restrictions such as within the company's articles of association. All rights in violation with applicable market rules must be dissolved, of which the board appointment rights is one of the central subjects of discussion if a majority shareholder retains its majority position post the initial offering.

Lock-up restriction may apply depending on the transaction and the function and demand of the appointed advisers, whether it is book runners, underwriters or the recommendation of any other financial adviser. If the owners are considering a full exit of their holdings, a lock-up period will mitigate the price drop of a sudden disposal. If a financial adviser is acting as an underwriter, he or she would normally not be willing to take on the associated price risk of such sudden disposal upon listing. A lock-up period of at least six months or a year would be common in such case.

When disposing the shares, the owners normally use book runners and financial institutions to identify investors and allocate shares, sometimes following an auction process. If an underwriter is appointed, the institution will itself purchase the agreed number of shares if the institution fails to allocate the shares to the market at the time of listing.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Historically, the number of going-private transactions has been limited on the Swedish market because of high valuations of Swedish public companies. In recent years, however, public tender offers, involving PE players as well as strategic buyers, have increased significantly. The targets include companies in the technology, manufacturing and retail sectors.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Being one of the most internationally integrated economies in the world, Sweden is generally considered to be an attractive country in which to invest. There are no structuring or financing issues that are unique to cross-border going-private or PE transactions. Foreign entities may acquire shares in Swedish corporations or become partners in Swedish partnerships without obtaining permission from any Swedish authorities. Sweden has no foreign investments restrictions, save from certain sensitive areas such as the energy, nuclear and defence sectors.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Swedish law does not contain any restrictions that prevent or constrain a PE firm to take part in club or group deal among other PE firms (or one or more PE firms and a strategic partner). When PE firms enter into a cooperation of this nature, the financial strength and capability of each party are the focus of attention.

In order to set out the respective rights and obligations of each party as joint owners, the conditions between the participants in a club or a group deal are generally regulated in a shareholders' agreement. The tenderers need to respect any confidentiality undertakings in favour of the seller when forming the club. A prohibition against entering into a club without the seller's consent is common.

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20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Although deal-specific, some key issues related to certainty of closing can be identified. The competition clearance process and the process of mandatory government approval concerning target companies in certain sectors (eg, financial institutions) cannot be evaded if they are or become applicable. Further, the purchaser's ability to obtain financing at a reasonable cost and the management of due diligence findings prior to closing are of course subject to negotiation that largely depends on the parties' negotiation power.

The parties typically try to manage all non-mandatory filing-related issues prior to signing. If signing and closing cannot take place simultaneously, certainty is traditionally obtained by making the closing subject to certain conditions (related to the above-mentioned issues) that have to be fulfilled. A waiver clause is included in the purchase agreement that allows either party to, at its sole discretion, waive the conditions not fulfilled or to terminate the agreement. Traditionally, neither of the parties is entitled to a termination fee as a result of a condition precedent not being satisfied. The closing precedents are, however, typically kept to a minimum. For instance, PE transactions between Swedish players rarely contain material adverse change provisions.

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Switzerland

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Types of transactions
With the Swiss private equity market benefiting from a generally good market environment and a relatively robust outlook, all standard transaction strategies to invest in, grow or acquire profitable portfolio companies are present in Switzerland. In terms of transaction values, however, the bulk of private equity funds still flows into buyout deals. Rescue or turnaround investments, on the other hand, remain insignificant. In the past three years, a consistently large share of about 75 per cent of the total number of private equity deals took the form of venture capital financing rounds. Start-up companies have continued to benefit from increasing investments, with approximately 909 million Swiss francs (compared with approximately 670 million Swiss francs in 2015) being raised in 151 rounds of financing in 2016 (compared with 120 financing rounds in 2015). However, the value of the median of all start-up financing rounds remains relatively low (approximately 2.5 million Swiss francs).

Structures commonly used
The majority of buyout or growth investments in Switzerland are structured so that the fund incorporates a new Swiss company, which then serves as a special-purpose acquisition vehicle (SPV) to purchase the shares in the target portfolio company. While such SPV is typically formed with only the minimum share capital of 100,000 Swiss francs, the fund managers draw down the capital committed by the investors shortly before the transaction in order to fund the SPV with the required equity to complete the transaction. Private equity houses focusing on venture capital investments, on the other hand, generally acquire participations in portfolio companies directly through one (or several) of their investment funds by subscribing for shares issued in a capital increase of the target company.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The main rules relating to corporate governance in Switzerland are as follows:

- the Swiss Federal Code of Obligations (CO), in particular articles 620 et seq, which are partly mandatory and govern any Swiss stock corporation, irrespective of whether it is privately held or listed on a stock exchange;
- the Swiss Federal Act on enforcement of the recommendations of the Financial Action Task Force entered into force partly in July 2015 and partly in January 2016. It states, inter alia, that any shareholder acquiring more than 25 per cent of a company must disclose its ultimate beneficial owners to the company for transparency purposes, failing which the rights of the shareholder (voting rights, rights of dividends) are suspended;
- the Financial Markets Infrastructure Act (the FMIA, which entered into effect on 1 January 2016, replacing the previously relevant sections of the Swiss Federal Act on Stock Exchanges and Securities Trading) and its implementing ordinances, which, inter alia, contain rules regarding the disclosure of significant shareholdings and public tender offers with respect to Swiss companies listed on a stock exchange in Switzerland and non-Swiss companies with a primary listing on a stock exchange in Switzerland;
- the ordinance against excessive remuneration by listed companies, which applies to corporations organised under Swiss law whose shares are listed on a stock exchange in Switzerland or abroad (foreign companies only listed on a Swiss stock exchange or merely having tax residence in Switzerland are not affected) and provides, inter alia, for the mandatory election by the shareholders of the chairman of the board and the members of the remuneration committee, an annual binding shareholder vote on the aggregate remuneration of the board and the executive committee, and the prohibition of certain forms of remuneration for the members of the board and the executive committee (eg, severance payments, advance payments, payments related to the acquisition or disposal of businesses); the main principles contained in the above-mentioned ordinance are meant to be implemented in the CO (the bill was adopted by the Swiss government in November 2016 and is currently under review by the Swiss parliament);
- the listing rules of the SIX Swiss Exchange (SIX Listing Rules) and its implementing directives, which, inter alia, contain periodic financial reporting and other continuing and ad hoc reporting rules applying to companies whose shares are listed on the SIX Swiss Exchange;
- the Directive on Information relating to Corporate Governance of the SIX Swiss Exchange, which requires Swiss companies listed on the SIX Swiss Exchange and non-Swiss companies with a primary listing on the SIX Swiss Exchange to disclose in their annual reports certain information on the board and the senior management, their compensation and the control mechanisms;
- the Directive on the Disclosure of Management Transactions of the SIX Swiss Exchange, which requires Swiss companies listed on the SIX Swiss Exchange and non-Swiss companies with a primary listing on the SIX Swiss Exchange to disclose transactions in the company's shares and related instruments by members of the board and the senior management; and
- the Swiss Code of Best Practice for Corporate Governance issued by Economiesuisse, the umbrella organisation representing the Swiss economy, which sets forth corporate governance standards in the form of non-binding recommendations primarily for listed companies. These recommendations are divided into four parts (shareholders, board of directors and executive management, auditing, and disclosure) and, although not binding, these rules have become standard for listed companies.

It follows from the above that the vast majority of corporate governance-related rules and regulations applies to listed companies, only with the exception of the limited governance-related provisions contained in the CO that apply to all stock corporations irrespective of whether they are

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listed or private. The mandatory corporate governance rules applying to private companies are thus much lighter and limited to the provisions of the CO. Although such rules are more limited in scope, governance issues can, for example, arise if financial investors (eg, in the context of venture capital investments) hold minority interests in the portfolio company but have far-reaching control and veto rights through their representatives in the board of directors of the portfolio company, in which case potential conflict of interest scenarios may arise where corporate governance principles will become important.

It should also be noted that special rules on corporate governance apply to banks and insurance companies and to investment companies with variable capital or fixed capital. In particular, the FINMA Circulars on Corporate Governance of Banks, on Corporate Governance of Insurance Companies and on Minimum Standards for Remuneration Schemes of Financial Institutions set forth minimum standards for corporate governance and the remuneration schemes of banks, insurance companies and other financial institutions (meeting certain financial thresholds).

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Going-private transactions of listed companies in Switzerland usually occur through a public tender offer pursuant to the rules of the FMIA or a merger pursuant to the Swiss Merger Act (SMA), whereas private equity transactions in general are conducted according to the common rules of the CO. Under Swiss law, the members of the board of directors are bound by fiduciary duties and by the principle of equal treatment of all shareholders. In addition, the FMIA contains provisions to ensure transparency, fairness and equal treatment of shareholders in corporate takeovers.

In particular, the board's fiduciary duties imply the duty to take measures, or rather, to apply procedural safeguards in order to avoid the effects of potential conflicts of interest. The appointment of independent directors or the establishment of a special (ad hoc) committee is one of these procedural safeguards. The special committee shall be composed of at least two members who are not participating or do not have an interest in the transaction. Other measures include abstention of conflicted board members and obtaining of a fairness opinion. Should the board of directors issue a recommendation on a public tender offer, it will usually obtain a fairness opinion from an independent audit firm or investment bank. The board's recommendations will then be based on such fairness opinion. Members of the senior management may have to abstain from decisions on a transaction in case of a conflict of interest, whereas significant shareholders generally do not directly represent the company in a transaction and may pursue their interests as set forth in the articles of association and by exercising their voting right at shareholders' meetings.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

According to the SIX Listing Rules, listed companies must inform the market of any price-sensitive facts that have arisen in their sphere of activity (ad hoc publicity). Price-sensitive facts are facts that are capable of triggering a significant change in market prices. Based on this provision, going-private transactions might need to be disclosed at an early stage. However, the issuer may postpone the disclosure of a price-sensitive fact if the fact is based on a plan or decision of the issuer and its dissemination might prejudice the legitimate interests of the issuer. The issuer must ensure that the price-relevant fact remains confidential for the entire time that disclosure is postponed. In the event of a leak, the market must be informed about the fact immediately.

Moreover, if a going-private transaction takes the form of a public tender offer, the bidder shall publish an offer prospectus, and the board of directors of the target shall publish a report containing all necessary information in order for the shareholders to be able to assess the offer. The board's report shall describe the effects of the offer on the target and its shareholders. It may contain a recommendation on whether to accept the offer, or may only set out the pros and cons of the offer without making any recommendation. It shall further specify the intentions of the shareholders who hold more than 3 per cent of the voting rights, any defensive measures of the target as well as any potential conflicts of interest.

Should a going-private transaction be effected by way of a merger (see question 6), the board of directors of the target will have to provide a detailed report, which, inter alia, shall explain the consequences of the merger, the merger agreement and the exchange ratio. Such report shall then be verified by an independent auditor. Furthermore, during the 30 days preceding the merger, the shareholders have the right to inspect the documentation relating to the merger (including the merger agreement, the merger report, the audit report as well as the financial statements of the companies taking part in the merger).

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

The following elements may, inter alia, influence the timing of a going-private transaction involving a listed company:

- in the case of a going-private transaction occurring through a public tender offer: the process starts by a pre-announcement; within six weeks of such pre-announcement, the bidder shall publish the offer prospectus; the offer can be accepted 10 trading days after publication of the prospectus at the earliest (the 'cooling-off period'); the offer shall remain open for 20 to 40 trading days; if the offer was successful the bidder must afford the shareholders an additional period of 10 trading days to accept the offer (all deadlines may be reduced or extended by the Swiss Takeover Board upon request);
- in the case of a going-private transaction occurring through a merger: the merger agreement, the board report on the merger and the audit report have to be issued 30 days prior to the shareholders' resolution on the merger; in addition, the merging companies might need to observe a consultation period with the employees prior to the merger should the contemplated merger have any consequences on the employment conditions; moreover, within three months of the publication of the merger, creditors may require that their claims be secured;
- for companies whose shares are listed on the SIX Swiss Exchange, the Directive on the Delisting of Equity Securities, Derivatives and Exchange Traded Products (SIX-DD) is applicable; in principle, the SIX-DD requires that the listing must generally be maintained for at least three and a maximum of 12 months from the delisting announcement (continued listing period); shareholders in general merely have the (limited) right to challenge the delisting decision with regard to the continued listing period; and
- merger control notifications and approvals, governmental consents required in regulated industries, and the obtaining of tax rulings, as applicable, may also influence the timing, as they may take a few months depending on the circumstances.

Private equity transactions not involving a listed company generally do not have different timing considerations from any other Swiss mergers and acquisitions transactions, except that the securing of third-party financing may require additional time.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Going-private transactions in Switzerland are typically effected through a public tender offer, which is followed by a squeeze-out of any remaining minority shareholders. There are basically two alternate routes for squeezing out minority shareholders of a Swiss company

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listed on a stock exchange in Switzerland upon completion of a public tender offer.

According to the FMIA, the bidder in a public tender offer may squeeze out the remaining minority shareholders of the target company if such bidder holds more than 98 per cent of the voting rights in the target company. In such a case, the bidder may apply for a court decision cancelling the remaining equity securities of the target. The minority shareholders are entitled to receive the tender offer consideration for the cancelled shares. The request to the court must be made within three months of the end of the additional acceptance period for the public tender offer (see question 5).

Alternatively, the SMA provides for the possibility to squeeze out the minority shareholders by virtue of a squeeze-out merger if at least 90 per cent of the shareholders entitled to vote in the absorbed company's (ie, the target's) shareholders' meeting agree to such a merger. The squeezed-out minority shareholders can be forced to accept cash (or other kinds of assets) in exchange for their shares in the target.

Although the aforementioned thresholds may appear high, they are frequently reached in practice if a public tender offer has been successful and the consideration that has been offered is attractive.

In case of a statutory squeeze-out pursuant to the FMIA the minority shareholders have the right to adhere to the court procedure and bring forward their arguments. However, they almost never do so owing to the very limited grounds that can be asserted in such procedure. Importantly, the court has no power to reconsider the tender offer consideration in a squeeze-out in accordance with the FMIA. In contrast, the minority shareholders in a squeeze-out merger pursuant to the SMA have appraisal rights and may challenge the merger resolution arguing that the consideration received in exchange for their shares is not adequate. The squeezed-out minority shareholders may in such circumstances bring an action within two months of the publication of the merger resolution. However, such action does not hinder the legal effectiveness of the merger. Also, because of the restrictive case law of the Swiss Federal Supreme Court, the risk of a successful challenge is rather low if the squeeze-out merger is carried out within a short period of time of a public tender offer.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Sale and purchase agreements (in buyout deals) and investment agreements (in venture and growth capital deals) usually contain a comprehensive catalogue of representations and warranties, including with regard to title, organisation, financial statements, tax, intellectual property, employees and social security, real estate, material contracts and absence of litigation. This catalogue is usually reduced in the case of MBOs, since the buyers have been involved in the management of the target or have profound knowledge about the target or extensive access to the management, or both.

Sale and purchase agreements usually also contain specific indemnities, including full indemnities with respect to taxes or other special risks identified during the due diligence process.

In the case of staggered payment of the purchase price in the context of a buyout transaction, because of the often thin capitalisation of the purchasing vehicle, the seller will usually require a bank guarantee from the purchaser or special undertakings or a guarantee from the parent company.

In case of venture capital transactions or if the target company continues to have several shareholders upon completion of a buyout transaction, the acquirers and any continuing shareholders regularly conclude a shareholders' agreement alongside with the purchase or investment agreement (see question 13 for key provisions included in such shareholders' agreements).

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

There are two types of equity-based incentives: participation of the management from the outset (MBO) or stock option plans providing for a successive participation, which may be implemented at any time. The Federal Act on the Taxation of Employee Equity Incentive Plans, which became effective in 2013, and its implementing ordinance are noteworthy in this context. While these rules did not fundamentally change the taxation rules previously developed by the practice of the cantonal tax authorities, they clarify certain issues that had given rise to varying cantonal practices and provide for additional reporting duties for Swiss employers who have employees participating in employee equity incentive plans. It is thus important to review any existing tax rulings that had been sought prior to 2013 and to ensure that appropriate reporting procedures have been set up. Other benefits in the form of remuneration, bonuses and further compensation are usually granted through employment agreements.

Although there are no specific timing considerations regarding the determination of management participations, any management incentive is, however, susceptible to creating conflicts of interest in the context of a going-private transaction, since the management is bound by fiduciary duties and has a duty to act in the best interest of the company. Accordingly, in case of a public tender offer, the board report shall disclose any arrangements between the bidder and the board or management of the target company, as well as the measures that will be taken in order to avoid any adverse effects of the conflict of interest on the shareholders. In case of a merger, the merger agreement shall also disclose any advantage granted to the management.

As regards companies in the financial industry, consideration must also be given to the Remuneration Circular of FINMA (which has been revised and entered into force on 1 July 2017) that sets minimum standards for remuneration schemes in banks, insurance companies and other financial institutions (meeting certain financial thresholds), putting particular emphasis on the sustainability of remuneration practices (especially regarding variable remuneration) and the prevention of incentive distortions, as well as the new ordinance against excessive remuneration (see question 2).

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Taxes are levied at three different levels in Switzerland: federal, cantonal and municipal. The cantonal and municipal rates vary markedly across Switzerland, as cantons and municipalities are free to determine their tax rates. This said, the rates are generally below the average tax rates in Europe and are reviewed on a yearly basis. The ordinary effective corporate income tax rates currently range between approximately 11 per cent for the lowest canton and municipality and approximately 24.5 per cent for the highest.

Special tax regimes, such as the auxiliary, principal and holding company regimes, are in principle still available to date. These special tax statuses as well as Swiss finance branches are meant to be abolished in order to comply with international accepted standards. However, as the Corporate Tax Reform Act III was rejected in a popular vote (in February 2017), the abolition of these special tax regimes has been delayed (a new tax reform is currently being discussed by the Swiss parliament, but is not expected to enter into force before 2020). Despite some cantonal particularities, the Corporate Tax Reform, which will be implemented in the foreseeable future, can be generally described as follows. Companies that currently benefit from such special status will then forthwith be subject to regular taxation, provided that, for a limited period of five years after the abolition of such special regimes,

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profits generated from assets and goodwill (ie, hidden reserves) that so far benefited from the special status treatment will be taxed at a lower rate. To maintain the attractiveness of the Swiss tax system, the Corporate Tax Reform will be associated with a general significant decrease by the cantons in their effective corporate income tax rates (eg, in the Canton of Vaud as of 2019), the adoption of the 'patent box', pursuant to which specific intangible property income may be subject to reduced taxation under certain circumstances (a patent box already exists in the Canton of Nidwald), and a 'super deduction' for R&D. The special regimes currently still in place are as follows:

- the auxiliary company regime allows companies to benefit from a significant tax exemption of foreign source income, provided that the scope of the commercial activity carried out in Switzerland is limited;
- the principal company regime is, in essence, a lump-sum exemption of the corporate income tax base granted in consideration of foreign permanent establishments; it is available to companies that assume certain key regional functions on behalf of a multinational group; and
- the holding company regime applies to holding structures and mainly consists in the exemption of corporate income tax at cantonal and municipal levels; holding companies frequently also benefit from 'participation relief' for income generated from dividends or capital gains from investments in other companies (subject to their participations meeting certain conditions), or both. The 'participation relief' is also available for ordinarily taxed Swiss companies if the relevant conditions are met.

Tax holidays, namely full or partial exemptions from corporate income and capital taxes for newly established businesses, may typically be granted to industrial companies. The main criteria for such tax holidays to be granted are the number of new positions created and the investments made in the canton where the company has its corporate seat.

Interest on debt is deductible from taxable profits, regardless of whether the debt is subordinated. This said, there are limitations on the deductibility of interest in connection with shareholder or related-party loans based on arm's-length rules for interest rates and thin-capitalisation rules (see question 10).

Executive compensation generally qualifies as taxable income of the relevant recipient. Incentive compensation awarded in the form of cash, shares or options is taxed at the time of award, except for unlisted or restricted options that are taxed upon exercise.

Capital gains realised by Swiss-resident individuals on privately-held assets, such as shares, are generally exempt from income tax. Exceptions apply to real property.

Share deals generally cannot be classified as asset acquisitions in Switzerland and may trigger a transfer tax of up to 0.3 per cent of the consideration if a securities dealer pursuant to the Swiss Federal Act on Stamp Duties is involved in the transaction. Asset deals usually involve VAT on assets or services, which is typically settled in a notification procedure.

The issuance of a company's share capital, as well as additional contributions in cash or in kind into the company's equity, are subject to Swiss issuance stamp tax at the rate of 1 per cent. However, contributions against issuance of new shares not exceeding an aggregate amount of 1 million Swiss francs and contributions that qualify as business restructuring are exempt.

A 35 per cent withholding tax is levied on profit distributions (including any hidden dividends and distributions of liquidation proceeds) by Swiss companies. This rate can be reduced or fully reclaimed if the dividend is paid to a Swiss-resident shareholder or if a double tax treaty applies (see question 18). By contrast, the repayment of contributions made by direct shareholders into the equity of a Swiss-resident company is not subject to Swiss withholding tax.

Pursuant to the practice of the Swiss tax authorities, the application of special tax regimes as well as the tax consequences of significant transactions involving Swiss-resident companies may be (and typically are) secured by written tax rulings. In this connection, it is worth pointing out that some tax rulings may be subject to spontaneous exchange of information following implementation of the OECD's Base Erosion and Profit Shifting Project.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Private equity investors usually provide financing in the form of mezzanine debt or subordinated loans. In the context of leveraged buyouts, one will generally use senior and junior debt in the form of revolving and term credit facilities provided by financial institutions.

Customarily, banks providing the acquisition financing will require that the existing debt be refinanced and that the existing security be released and used as collateral to secure the acquisition financing.

The target can only provide security interest up to the amount of its freely disposable reserves. The target's ability to grant upstream or cross-stream guarantees or other types of security shall be included in the corporate purpose clause of the target's articles and must be approved by the shareholders (see question 12). Similarly, a Swiss Federal Supreme Court decision in 2014 has set stricter requirements for group financial assistance, in particular with regard to the definition of 'at arm's length' upstream and cross-stream loans. Loans that do not meet the relevant requirements reduce the target's ability to distribute dividends (as reserves in the amount of the loan have to be created). If distributions in excess of free equity have been made, the company has a claim for repayment against the recipients of such distributions, and the board of directors may become responsible to the company, its shareholders and the creditors.

There are no statutory margin or corporate minimum capitalisation requirements in Switzerland. However, de facto limitations result from the thin-capitalisation rules applied by Swiss tax authorities. Interest paid on amounts of debt exceeding certain thresholds may be requalified as a hidden dividend if paid to a shareholder or a related party of a shareholder. In addition, as per Swiss tax law, interest shall respect the principle of 'dealing at arm's length'. In this context, the Swiss federal tax administration annually publishes guidelines providing for minimum (for loans to shareholders) and maximum (for loans from shareholders) interest rates. Those rates are deemed to reflect an arm's-length remuneration. Subject to proper evidence, the tax authorities may accept interest rates deviating from the yearly guidelines. Interest paid on excessive debt or that is not in line with the minimum/maximum rates would not be tax deductible and would be subject to 35 per cent withholding tax. If a loan is granted by a third party but guaranteed by the parent company, the thin-capitalisation rules also apply.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Generally speaking, there are no specific provisions related to the debt and equity financing in a merger agreement. In contrast, in the context of a public tender offer, the offer prospectus must contain information regarding the financing of the offer, as well as a statement from the independent review body that the bidder took all necessary measures so that the financing was available at closing (certainty of funds). However, the bidder is not required to summarise the financing terms and conditions or to publish any financing documents. In practice, very short statements in the prospectus have become standard (for instance, it is considered sufficient if the prospectus states that 100 per cent of the offer will be financed through a bank facility). This practice is justified by the fact that the review body must, in particular, assess the financing of the offer and the availability of funds before the offer is published. Where funds required for the offer are borrowed, the review body examines, in particular, the creditworthiness of the lender and the contractual terms that enable the lender to withhold the disbursement of the funds.

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12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Fraudulent conveyance issues are rather exceptional in private equity transactions other than in rescue and turnaround deals. In distressed situations, however, careful consideration has to be given to the structuring of the transaction and the terms of financing provided to a troubled company.

Transactions within a suspect period of up to five years before declaration of insolvency may be challenged if the consideration received was in manifest disproportion to the insolvent debtor's own performance. Furthermore, it must be ensured that the injected funds are not used to replace existing unsecured financing and that there are reasonable prospects of a successful restructuring of the distressed target company, as otherwise loans granted to the target might be subordinated to the claims of other creditors in the event of insolvency. In this context the more recent amendment of the Swiss Debt Enforcement and Bankruptcy Act (which became effective in 2014) brought about some noteworthy changes with respect to the ability of third parties to challenge a transaction and introduced certain mechanisms to facilitate restructuring measures for insolvent companies.

Like upstream or cross-stream loans, upstream or cross-stream guarantees or other security interests granted by the target in respect of obligations of a parent or an affiliate (other than a subsidiary) are also subject to various requirements and limitations (see question 10), which call for adherence to the formalities applicable to distributions to shareholders and may limit the enforceability of such guarantee for the benefit of an affiliate. Similarly, if the target company does not receive adequate consideration for entering into and maintaining such guarantee, any sum received thereunder may be challenged if the target were to become insolvent.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements customarily restrict the transferability of shares and provide for a combination of rights in respect of the sale of shares (rights of first offer, pre-emption rights, call and put option rights, drag-along and tag-along rights), sometimes safeguarded by share escrow arrangements or conditional assignments of shares. Further common key provisions include voting undertakings, special quora and majorities (veto rights) for certain reserved board and shareholder matters, information rights, covenants regarding the company's business and management, provisions regarding voluntary and mandatory conversion of preferred shares (if applicable), and board appointment rights. In situations where it is important that no single party has control of the board, the shareholders' agreement may provide for a certain number of independent directors. In venture capital financings, the shareholders' agreement commonly provides for dividend and liquidation preferences and anti-dilution protections of the investor.

Occasionally, adherence to the shareholders' agreement is safeguarded by indemnities for breach of contract or call options exercisable against a breaching party. To the (limited) extent permissible under Swiss law, certain provisions of the shareholders' agreement are generally also embedded in the constitutional documents of the company. The Swiss Private Equity and Corporate Finance Association has published a model documentation for venture capital transactions involving institutional investors and is about to launch a simplified model documentation for smaller investments by business angels and similar seed stage investors.

Pursuant to the principle of equal treatment of shareholders the board and the shareholders' meeting must give equal treatment to all shareholders. Core statutory shareholder rights are the right to participate at shareholders' meetings, information and inspection rights, and the right to receive a share of any dividends and liquidation proceeds. Shareholders also have a pro rata pre-emptive right (which may be restricted for certain important reasons) to any newly issued shares or bonds which are convertible into equity. Shareholders representing more than 33.33 per cent of the voting rights can block a number of key resolutions (for example, qualified capital increases, limitation of pre-emptive rights or corporate reorganisations such as mergers).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

The FMIA provides for a mandatory offer regime. A person or group of persons acting in concert and acquiring more than 33.33 per cent of the voting rights of a Swiss company listed on a stock exchange in Switzerland (or of a foreign company if its primary listing is on a stock exchange in Switzerland) is required to make a public tender offer for all listed shares of that company, unless such company's articles of association provide for an 'opting-up' (up to 49 per cent) or 'opting-out' of that requirement. The majority of Swiss listed companies (approximately 70 per cent) are subject neither to an opting-out nor an opting-up. Furthermore, any person that reaches, exceeds or falls below certain thresholds of voting rights (3, 5, 10, 15, 20, 25, 33.33, 50 or 66.66 per cent) must notify the company and the stock exchange.

To carry out a squeeze-out merger or a statutory squeeze-out in a going-private transaction, a bidder must hold at least 90 per cent (98 per cent in the case of a statutory squeeze-out) of the share capital and voting rights of the target (see question 6). Although voluntary bids in a public tender offer can be made subject to a minimum acceptance condition, the acceptance threshold may normally not exceed two-thirds of the target's issued shares (if the bidder does not previously hold a significant stake).

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

A private equity firm's ability to exit its investment very much depends on the terms of the investment documents and especially the shareholders' agreement. Contractual arrangements regarding transfer restrictions and exit rights are particularly decisive. While the right to coerce the other shareholders to a sale (drag-along) or to unilaterally request an IPO can facilitate the exit of the private equity investor, minimum rights of the common shareholders (for example, minimum valuation thresholds) may have a limiting effect. Ultimately, the terms agreed upon are a direct reflection of the parties' negotiation leverage and primarily hinge on the size of the investment and the relative attractiveness of the target.

For an IPO on the SIX Swiss Exchange, the target, inter alia, must have a certain minimum size. The Listing Rules require an adequate free float of the company's securities at the time of listing (generally, at least 20 per cent of the issuer's outstanding securities in the same category must be in public ownership and the capitalisation of those securities must amount to at least 25 million Swiss francs).

In general, private equity firms are reluctant to assume liabilities surviving the exit, will aim at a low cap on any indemnities and will seek to include a high de minimis, deductible or threshold. Potential claims for indemnification of the buyer are sometimes secured by holding a portion of the purchase price in escrow for a certain period of time. In addition, we have seen an increased interest in Swiss private equity deals to obtain insurance coverage for otherwise existing exposure under representations and warranties, in particular where there is non-alignment of involvement, knowledge and pockets among numerous sellers.

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Update and trends

2017 was another strong year for Swiss M&A despite a difficult international geopolitical context, including the decision of the United Kingdom to leave the European Union and the tumultuous US presidential election, as well as complicated domestic politics with the refusal by Swiss voters to reform the corporate tax regimes.

Switzerland witnessed the largest transaction in its history with the acquisition of Syngenta by China National Chemical Corporation (ChemChina) completed in 2017. The deal totalled over US$43.3 billion and was the largest outbound investment ever made by a Chinese investor. This megadeal is another illustration of the rise of Chinese investors' focus on opportunities in Switzerland. It follows the investment by the Chinese conglomerate HNA Group in several Swiss companies: Glencore's storage business, Dufry, Gategroup and Swissport; and the sale of the Swiss bottle manufacturer SIGG to the Chinese group Haers.

Aside from the sale of Syngenta to ChemChina, the most active sectors in Switzerland in 2017 were pharmaceuticals and life sciences. Major deals in 2017 included the sale of the Swiss biotech company Actelion Pharmaceuticals to the American firm Johnson & Johnson for approximately US$30 billion and the acquisition of Basel-based Capsugel by Lonza for US$5.5 billion.

Looking at private equity, the low interest rates and strong currency continued to create a favourable situation for outbound deals from Swiss private equity houses, in line with the past two years. A noteworthy deal was the acquisition of an 80 per cent stake in Breitling by CVC Capital Partners. Venture capital investments in Swiss start-ups remained strong, on the back of having almost tripled in the past five years to reach nearly 1 billion Swiss francs. More than 60 per cent of SME acquisitions in the first half of 2017 were cross-border with over a third coming from North American and Japanese companies.

This favourable environment for Swiss start-ups is likely to continue, since it is supported by the Swiss government, which created Innosuisse, a Swiss agency starting operation from early 2018 and aiming to promote innovation in Switzerland. Similarly, the Swiss government recently amended banking regulations in order to lower the requirements for activities in the fintech sector, with the goal of opening up innovation in the strategic banking sector.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Governance rights and other shareholders' rights typically included in shareholders' agreements normally do not survive an IPO, as shareholders' agreements usually terminate upon the IPO (otherwise, disclosure in the prospectus would be required). The survival of board appointment or veto rights is highly unusual. If the pre-IPO capital structure includes various categories of shares, it is customary to simplify the share structure before the IPO. Shareholders' agreements generally anticipate this issue by providing for the mandatory conversion of preferred shares in the event of an IPO.

Lock-up provisions are usually subject to negotiation between the private equity firm and the incumbent shareholders. Typically, the investor wants to anticipate the requirements of the underwriters and have the core shareholders agree to execute lock-up and market standoff arrangements (if and as requested by the underwriters) already in the shareholders' agreement, as otherwise its right to unilaterally request an IPO could be put in question. The underwriters generally require that the core shareholders (management and founders, private equity investors) commit themselves to a lock-up of between 180 days and 18 months.

Under the SIX Listing Rules, all shares of the same class must be listed. There is no registration requirement for post-IPO sales of shares in Switzerland. Hence, private equity sponsors are generally free to dispose of their shares in a portfolio company following its IPO (subject to any lock-up or other contractual arrangements; notification duties also apply, see question 14). Strategies commonly seen are disposals pursuant to a 'dribble-out' trading plan, in which the shares are sold piecemeal in the secondary market over the course of days or a few weeks (depending on market conditions and the size of the stake), or trades in a larger block of shares (usually to a single buyer).

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Traditionally, private equity firms have invested in a wide array of industries in Switzerland, reflecting the well-diversified Swiss economy. In the recent past, the sectors that have experienced most deal activity both in terms of number and value of transactions were pharmaceuticals and life sciences (including biotech) as well as information and communications technology. In particular, in venture capital financings, it is noteworthy that the three largest capital rounds (ADC Therapeutics, Mindmaze and Cardiorentis) and 19 of the top 20 start-up financings in 2016 were all in these sectors. Additionally, business and industrial products and services have also attracted a larger share of private equity investments.

There are no regulatory schemes specifically targeted at private equity firms. However, there are a number of regulated industries where certain limitations must be considered. Regulatory restrictions exist, for instance, in the banking, securities trading, insurance, telecommunications and media sectors. Generally speaking, the acquisition of control or a minority stake of a company holding a banking, securities dealer, insurance, radio or television broadcasting licence is subject to prior notification to or authorisation by the competent regulatory body. There are restrictions on permitted foreign ownership in a number of other regulated sectors such as aviation, nuclear power generation and other areas of public infrastructure.

The direct or indirect acquisition of real estate for residential purposes in Switzerland by 'persons abroad' (non-Swiss nationals and other foreign entities) is subject to legal restrictions and may require a special authorisation.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There are no foreign exchange control or similar laws generally restricting investments or acquisitions in Switzerland by persons or companies domiciled abroad. Regulatory restrictions exist with regard to certain industries (see question 17). Rules regarding public tender offers apply irrespective of whether the bidder is a Swiss or a foreign company.

Generally speaking, any dividends and similar distributions (cash or in kind) made by a company to its shareholders are subject to a withholding tax of 35 per cent unless they come from paid-in share capital or additional capital contributions from the shareholders. Foreign beneficiaries of dividends may be entitled to a partial or full reduction of the withholding tax in accordance with applicable double taxation treaties between Switzerland and the beneficiary's country of tax residence or the agreement on the automatic exchange of information in tax matters between the EU and Switzerland (to the extent applicable).

Both immigration as well as emigration mergers are admissible under Swiss law if the laws of all involved jurisdictions so permit and the merger meets certain minimum criteria. While the requirements stated in the law appear straightforward at face value, the actual mechanics of a cross-border merger prove quite cumbersome in practice. Consequently, rather few transactions (other than intragroup reorganisations) structured as cross-border mergers have been seen thus far (except for large companies with substantial existing operations, especially in regulated industries such as insurance).

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19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Swiss law does not prevent or restrict the participation of two or more private equity firms in a club or a group deal. In 2016, about two-thirds of the private equity deals (approximately 75 per cent of the total funds invested) involving Swiss target companies were syndicated.

From a practical perspective, the participating investors generally lay down the terms and conditions governing their relationship in a formal shareholders' agreement (see question 13). This is advisable also because the group (often inadvertently) forms a 'simple partnership' pursuant to Swiss law, which imposes default rules regarding governance, representation rights, profit allocation and other aspects of their relationship.

In respect of listed targets, an additional issue to be considered is that firms partnering in a club deal will generally be regarded as acting in concert under the rules of the FMIA. As a result, their consolidated stakes in the target will be relevant for the assessment as to whether notification and mandatory offer obligations are triggered (see question 14), which may make the group susceptible to the actions of any one of the partner investors.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Certainty of closing is one of the key issues in any kind of mergers and acquisitions transaction. The simultaneous signing and closing can simplify smaller transactions, as it eliminates the risk of unforeseen events occurring during the period between signing and closing. It may also reduce the complexity of the purchase agreement. More often, however, the circumstances of the transaction call for a separation of signing and closing (for example, to obtain governmental approvals or third-party consents, or to call funds under equity commitments).

If there is a need for a separation of signing and closing, the parties will require each other to fulfil certain conditions before the transaction closes. At the same time, it is customary for the transaction agreement to provide for a 'long stop date' (ie, a date until which the transaction must close, failing which the agreement will terminate) and pre-closing obligations, such as covenants regarding the target's conduct of business or certain restructuring measures. In view of the high costs incurred by both parties in the context of a transaction, there is an increasing use of termination fees in the form of liquidated damages to alleviate the risk that the closing may not occur.

In public tender offers, only limited conditions are permissible in the offer (for example, regulatory approvals or acceptance thresholds; see question 14). A public tender offer may not be made subject to the obtaining of financing. The bidder and the target can agree on a break fee, provided that this does not result in coercing shareholders to accept the offer. Break fees must be disclosed in the offer documents. As a general rule, they should not substantially exceed the cost incurred by the bidder in connection with the offer.

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Turkey

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Private equity transactions in Turkey usually involve buyouts. In practice, private equity capital is primarily used by companies facing financial distress (but which are operationally viable) and unable to induce profitable investments owing to a lack of adequate financial resource. Additionally, private equity capital is utilised in Turkey by non-distressed companies aiming to develop their existing business and by entrepreneurs wishing to exit companies they have incorporated. Following company restructuring or a term of management over a few years, investors usually remain for two to five years and then seek high returns from a sale to a strategic buyer or a public offering. In some cases, private equity investors sell the target company to another private equity investment firm, as was the case in NBK Capital Equity Partners' sale of Yudum to Afia International, Carlyle's sale of Medical Park to Turkven and Esas Holding's sale of Peyman to Bridgepoint.

Commonly, private equity investments in Turkey are realised by acquiring the target company's shareholding through either a share subscription or a sale of shares, or both. Share purchase agreements and share subscription agreements are the main instruments for these investments. Another significant instrument is the shareholders' agreement to grant rights of first refusal and tag-along and drag-along rights, or alternatively, initiating a public offering for the private equity investor.

Foreign interest in Turkish companies has increased significantly since 2006. Major investments by Bancroft, Pinebridge Investments (ex-AIG Fund), Partners in Life Science UK Ltd, Citigroup Venture Capital International, KKR, NBGI, Carlyle Fund, Abraaj Capital, Bain Capital, NBK Capital, ADM Capital and Argus Capital have confirmed this trend. Since then, even larger investments have proved how dynamic the Turkish market has become. Recent private equity deals include the following:

- Franklin Templeton Investments' acquisition of a minority stake in DeFacto;
- Taxim Capital's acquisition of a minority stake in restaurant chain Big Chefs and its acquisition of a stake in Netcad;
- Abraaj's acquisition of Turkent Gıda (ie, KFC Turkey), Netlog Lojistik, Fibabanka, Hepsiburada.com and Yorsan, and stakes in Biletal İç ve Dış Ticaret AŞ (owner of biletall.com), BRN Yatak and Yu-Ce Medikal (through its newly established Anatolian Growth Capital Fund);
- NBK's acquisition of Inci Mobilya (Yatsan) and a stake in Sistem 9 Medya;
- Turkven's acquisition of Medical Park and its joint acquisition of Ziylan Magazacilik along with Gozde Girisim and Bim AS and its joint acquisition of MNG Kargo with the Sancak family;
- Actera's acquisition of Korozo Ambalaj and its joint acquisition of UN Ro-Ro with Esas Holding; and
- Turkven's exit from Mavi through an IPO on the Turkish stock exchange and its exit from DP Eurasia through an IPO on the London Stock Exchange.

The healthcare sector has become a significant area of interest for private equity investors. Major deals in the sector include the following:

- Abraaj Capital's acquisition of Acibadem (Abraaj succesfully exited Acibadem by selling its shares to Integrated Healthcare Holdings Sdn Bhd and Khazanah Nasional Bhd);
- NBK Capital's acquisition of Dunya Goz (NBK exited Dunya Goz by selling its shares back to the existing shareholders after three years);
- Carlyle Fund's acquisition of Medical Park (Carlyle successfully exited Medical Park by selling its shares to Turkven);
- Argus Capital and QFIB's investment in Memorial; and
- Fiba Holding's investment in Florence Nightingale Hospitals and Şifa Hospitals (Fiba exited these investments by selling its shares back to Florence Nightingale Hastaneleri Holding AŞ).

There is also a strong interest in public entities, which has coupled Turkish companies and foreign funds.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

One of the main problems in private equity transactions is private equity investor representation in the target companies and their subsidiaries' corporate bodies. In deals involving subsidiaries, the private equity investors' representatives often decline to join the subsidiaries' boards. In order to overcome this, contractual obligations are imposed on the seller's side, mandating the seller to reflect in its subsidiaries those corporate governance principles applicable to the target company. Such obligations, however, cannot be implemented under Turkish corporate governance rules. The Capital Markets Board of Turkey (CMB) issued corporate governance rules applicable only to listed companies (there are approximately 360 companies listed on the Borsa Istanbul stock exchange). While the guidelines on corporate governance are not strictly binding, listed companies are required either to implement the rules and declare their compliance, or explain the reason for their non-compliance in their annual reports. Yet companies have shown a relaxed attitude to such requirements because there are no statutory obligations to apply these guidelines. These corporate governance guidelines mostly relate to issues such as shareholder rights, duties of public disclosure and transparency issues, minority rights, independent auditing and the board of directors' duties. However, Communiqué No. IV/56, dated 30 December 2011 and issued by the CMB, provides several guidelines for listed companies. This communiqué was replaced by Communiqué No. II-17.1 on 3 January 2014. Together these communiqués require listed companies to comply with corporate governance rules on the right of general assembly participation, board of directors structure, guarantees, pledge and hypothec resolutions, committees within a board of directors and financial rights granted to board of directors members. The criteria and minimum number of independent directors are binding, as are all other provisions concerning independent directors. Communiqué No. II-17.1 also requires listed companies to establish the following committees:

(i) auditing committee;
(ii) corporate governance committee;

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(iii) risk determination committee;
(iv) nomination committee; and
(v) salary committee.

However, if the committees under (iii), (iv) and (v) cannot be established because of the organisation of the board of directors, the duties of such committees will be fulfilled by the corporate governance committee.

Under the new Turkish Commercial Code (TCC), effective as of July 2012, various clauses reflecting corporate governance rules are statutorily binding including those concerning announcements for general assembly meetings and publishing corporate information, such as shareholder structure and voting rights, prior to general assembly meetings.

The TCC also provides for new steps toward professional management and several provisions concerning company boards of directors introduce new concepts and fundamental changes, while others fill gaps evident in the repealed code. These include the following:

- allowing non-shareholders and legal entities to become board members;
- reducing the mandatory number of board members to one;
- introducing online board meetings;
- creating a clear distinction between a company's management and representation, enabling the transfer of 'authority to manage' a company to one or more board members or third parties; and
- reformulating board members' liability – introducing the 'business judgment' rule to replace the former 'prudent merchant' criteria.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

A squeeze-out was not possible in Turkey until a 30 July 2010 decision by the CMB set out principles and procedures for the voluntary delisting of public companies. Moreover, the new Capital Markets Law (CML) entered into force on 30 December 2012, introducing new mechanisms that substantially change Turkish capital markets legislation. The CML also regulated the majority shareholder squeeze-out right, but left it to a communiqué to explain how to exercise the right. In this respect, a communiqué entered into force on 1 July 2014, which was then amended, with the changes introduced on 12 November 2014.

Under the revised system, a shareholder acting alone or in concert with others holding 98 per cent or more of the total votes of a public company can exercise their squeeze-out right to purchase the shares of minority shareholders. Once the majority shareholder becomes eligible to squeeze out the minority shareholders, the minority shareholders will have the right to put their shares to the majority shareholder within three months. If there are any minority shares not sold during the three-month period, the majority shareholder can call the shares.

The minority sell-out price is the highest of the following:

- the weighted average trading price of the shares for the 30 days prior to the majority shareholder's disclosure of its intent to exercise its squeeze-out right;
- the amount specified in an independent valuation determining the value of each class or group of shares;
- the share price used in transactions such as a tender offer or merger in the last year prior to the majority shareholder's disclosure of its intent to exercise its squeeze-out right; and
- the weighted average of the weighted average trading price of the shares:
  - for the past 180 days;
  - the past year; and
  - the five years prior to the majority shareholder's disclosure of its intent to exercise its squeeze-out right.

Furthermore, according to the CMB's Communiqué on the Principles Regarding Public Disclosure of Material Events, Series VIII, No. 54 (Communiqué No. 54), if an individual, legal entity, or group of individuals or legal entities acting in concert directly or indirectly acquire the management control of a public company, they must make a tender offer to acquire the remaining shares. Management control is deemed to be achieved when the following occurs:

- the share capital or voting rights of the acquirer directly or indirectly reach 50 per cent or more; or
- privileged rights entitling the acquirer to appoint or nominate the majority of the directors are acquired.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Disclosure requirements under Turkish securities law are determined by two communiqués: Communiqué No. 54, applicable to listed companies, and the Communiqué on the Principles Regarding Public Disclosure of Material Events of the Corporations Whose Offered Securities are Non-Listed in a Stock Exchange, Series VIII, No. 57 (Communiqué No. 57), applicable to other public companies (ie, joint-stock companies that have over 250 shareholders but whose securities are not listed). Both communiqués require that all events affecting the value of the capital markets instrument or the investors' decision to buy or sell such an instrument be disclosed to the public. Communiqué No. 54 also introduces the right to postpone disclosure obligations in favour of listed companies.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

There are no specific timing considerations for private equity investments in Turkey. Typical aspects of a mergers and acquisitions transaction also apply to private equity transactions. In general, the due diligence, drafting and negotiation phases take no less than two months. Communiqué 2010/4 regulates the circumstances that lead to a requirement to notify the transaction to the Turkish Competition Authority (TCA). The TCA issued a new communiqué (Communiqué No. 2012/3) on 31 December 2012 revising article 7 of the current communiqué, which regulates the threshold test. Under these new changes, companies should notify the TCA regarding their merger when the following occurs:

- the combined Turkish turnover of the transaction parties exceeds 100 million liras and the Turkish turnover of each of at least two of the transaction parties separately exceeds 30 million liras; or
- the Turkish turnover of the asset or the activity to be acquired in acquisitions and of at least one of the transaction parties in mergers exceeds 30 million liras and the worldwide turnover of at least one of the other transaction parties exceeds 500 million liras.

Therefore, if a notification threshold is met, a filing must be carried out and TCA approval must be obtained prior to the proposed transaction's implementation. Please note that following a new amendment to the Turkish merger control regime introduced on 24 February 2017, acquisitions in the same relevant product market by the same undertaking within three years are regarded as a single transaction for the purpose of the calculation of whether the applicable turnover thresholds have been met.

Preparation for notification takes one to four weeks, depending on the complexity of the transaction and the volume of the required translation, and the TCA typically decides within four to six weeks. Therefore, the parties should envisage a period of at least two months between the signing and closing in which to obtain TCA approval. The

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notification must include the signed or current version of the transaction agreement. A transaction document indicating the agreed general structure of the deal (memorandum of understanding, letter of intent, term sheet, etc) may also be submitted, provided the clearance is obtained prior to the transaction's signing phase.

Depending on the nature of the transaction and target, other regulators or types of regulators can have jurisdiction over the transaction, such as the Banking Regulation and Supervision Agency for banks and certain other financial institutions, the CMB for brokerage houses, portfolio management companies and other companies that are active in capital markets, the Treasury for insurance and pension companies, the Energy Market Regulatory Authority for energy distribution and generation companies, and the Radio and Television Supreme Council for broadcasting companies.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

In principle, shareholders do not have statutory consent or approval rights in straightforward mergers and acquisitions transactions. However, shareholders may have contractual consent or approval rights deriving from a shareholders' agreement or a joint venture agreement executed between them. In these cases, if all the shareholders possessing these contractual rights are not cooperative regarding the mergers and acquisitions transaction at hand, issues and complications may arise.

Shareholders have a statutory pre-emptive right pro rata to their shareholding regarding shares issued under a capital increase. This should be considered in share subscription deals. This pre-emptive right can only be restricted or revoked based on valid grounds and by a general assembly resolution with an aggravated quorum. With respect to public targets, investors should be mindful of the close supervision of the CMB and lawsuits that may be filed by minority investors.

On the other hand, for going-private transactions there are a number of options for purchasers and shareholders:

Once the majority shareholder becomes eligible to squeeze out the minority shareholders, the minority shareholders will have the right to put their shares to the majority shareholder within three months (see question 3 for more details).

Furthermore, according to Communiqué No. 54, if an individual, legal entity, or group of individuals or legal entities acting in concert directly or indirectly acquire the management control of a public company, they must make a tender offer to acquire the remaining shares (see question 3).

Shareholders also have a sell-out right if the material events listed in the relevant communiqué of the CMB occur.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Representations and warranties are of central importance as they determine the framework of the seller's liability to the private equity investor. Under Turkish law, a share transfer is deemed a sale of shares (rights) exclusively, and is not considered a sale and transfer of the enterprise. Therefore, the seller's liability is limited to the respective shares and cannot be extended to the enterprise automatically. Representation and warranties are used to extend this liability. However, the provisions themselves do not achieve this. To protect private equity investors against any breach of representations and warranties regarding the enterprise, the legal character of the representations and warranties must be carefully crafted. There are several ways to structure the legal character of representations and warranties; however, in Turkish legal practice, the legal character of the representations and warranties is often not defined. In our view, the seller's representations and warranties can be structured as the seller's primary obligations. Although a debtor's primary obligations depend on the debtor's fault under Turkish law, parties may agree otherwise. In this respect, the structuring of the representations and warranties as the seller's primary obligation is insufficient without also including the seller's liability for its representations and warranties independent of the seller's fault in the parties' agreement. To overcome challenges arising from Turkish law provisions regulating the sale of goods, the seller should also guarantee against negative actions by third parties, such as governmental authorities and other third parties, regarding certain matters (namely, the seller should guarantee that no tax authority will file any legal or criminal complaint against the company and, failing this, the seller agrees to fully indemnify the company and its shareholders). To strengthen the protection of the private equity investor, the parties may agree that the investor's due diligence does not limit the seller's liability. In practice, however, sellers often challenge this. In such cases, another approach places the due diligence documents on a DVD attached to the share purchase agreement as an addendum.

Generally, sellers are increasingly convinced of the need for material adverse change clauses, but still attempt to quantify or otherwise limit them. In secondary buyouts where the seller is also a private equity firm, indemnification provisions may involve an amount in escrow. As a private equity fund may be wound up, investors are keen to secure a portion of the seller's potential liability with an escrow account. Typically, reaching an agreement on this amount is a lengthy, difficult process. In most cases, total liability is limited to a percentage of the purchase price. Remaining issues, such as representations and warranties in private equity investments, share the characteristics of other types of mergers and acquisitions.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

A significant portion of companies listed in Turkey are managed by a founding family, and consequently, management participation may be comparatively limited. In cases where the family members play a significant role in the business or there are key employees for the business, investors are ready to offer attractive compensation packages, including equity-based incentives or exit bonuses to facilitate the retention of family members or key employees at least for a certain transition period.

Another important development is the conditional capital increase system, a new procedure introduced by the TCC. In line with this new method, a company's general assembly may decide, by amending the articles of association (AoA) (or by drafting the AoA in such a manner during the incorporation), to conditionally increase the company share capital to enable holders of newly issued convertible bonds and similar debt instruments (ie, company creditors) to exercise their exchange rights, or to enable employees to exercise their stock purchase options, giving them the right to hold shares in the company. The practical impact will be that the conditional capital increase will allow the creation of a legal structure for employee stock option plans. A stock option mechanism was much desired by investors and, with the adoption of this mechanism under the TCC, stock option plans will be easier to realise.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

As a general rule, the gain the shareholder of the target company earns from the sale of its shares is subject to corporate income tax (CIT) at the standard rate of 20 per cent if the shareholder is a legal entity. However, if the shareholder has been holding printed share certificates representing its shares (the limited liability company shares or joint-stock company shares) for at least two years before their disposal, 75 per cent of the gain from the sale of its shares is exempt from CIT, provided the following conditions are met:

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- the sale price is received before the end of the second calendar year following the year in which the sale occurred;
- that the portion of the gain benefiting from the exemption is maintained in a special reserve account on the balance sheet for five years; and
- the selling company's business is not the trading of securities.

If the shareholder of the target company is a real person and if the target company is a joint-stock company, then the gain derived from the sale of his or her shares will be 100 per cent exempt from income tax on the condition that the real person shareholder holds the shares for more than two years and the share certificates representing his or her shares are printed.

If the target company is a limited liability company, then the gain derived from the sale of his or her shares will be subject to income tax of between 15 and 35 per cent.

Regarding stamp tax, papers with regard to the share transfers of joint-stock companies, limited liability companies and partnerships limited by shares is exempt from stamp tax with the amendment made on Stamp Tax Law by Law Amending Certain Laws to Improve the Investment Climate No. 6728, which entered into force on 9 August 2016.

For the acquirer, interest payments made for financing a transaction can be deducted from the tax base. These interest payments must be in compliance with the thin capitalisation and transfer pricing regulations.

Finally, there is no regulation that would classify a share acquisition as an asset acquisition for tax purposes.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Banks prefer senior (secured) debt for leveraged buyouts. Additionally, a number of mezzanine credit facilities can also be seen in the market.

There are no margin loan restrictions under Turkish law and banks are usually willing to provide credit to finance a target's acquisition. The new TCC, however, imposes new restrictions on financial assistance, potentially affecting the financing of leveraged buyouts. The new TCC also does not allow the shareholders of joint-stock companies to be indebted to their own companies unless the shareholder has fulfilled its capital contribution commitment in full and company profits cover the preceding year's losses. Additionally, joint-stock companies may no longer provide an advance, loan or security (eg, share pledge, assignment of receivables) for the acquisition of its own shares by a third party. The former code did not recognise or restrict financial assistance, and thus, private equities could obtain loans from banks to purchase company shares and in return provide the bank the target company's shares and assets as collateral. Under the TCC, legal transactions breaching this rule will be deemed null and void. The two exceptions are transactions concluded by banks and other financial institutions in their ordinary course of business (where the target itself is a bank or other financial institution) and transactions concluded by the company's employees (eg, management buyout) or one of its subsidiaries.

How the financial assistance prohibition will apply to limited liability companies under the TCC has yet to be clarified. Provisions for joint-stock companies that apply by reference to limited liability companies are indicated under the TCC; however, the financial assistance prohibition is not listed. The answer remains unclear about whether choosing a limited liability company will allow private equity funds to freely take share pledges from target companies. Moreover, this solution will not be possible for targets operating in regulated industries, which must be organised as joint-stock companies. These sectors include banking, debit and credit cards, financial leasing, factoring, consumer finance, asset management, foreign exchange dealing, brokerage, portfolio management, investment advisory services, insurance, auditing and agricultural and public warehousing.

Another financial assistance model may be considered as the TCC allows centralised cash management and cash pooling in intra-group companies. Intra-group companies can pool their excess cash under the parent company or in an intra-group financing company to be established for this purpose, provided such intra-group companies pooling their excess cash are entitled to request balancing from the parent. In that sense, the pooled cash can be used by the acquiring intra-group company requiring financial assistance.

There are no further restrictions on debt financing for private equity transactions.

In the event of change of control in a target company, the permission of the target company's creditors (banks, financial institutions and third parties) is often required under the agreements executed between the creditors and target company. The parties to the transaction often require this permission as a condition precedent to the share purchase agreements. A second issue that may arise concerns the target's collateral and other security for existing indebtedness.

The target company often requests the buyer private equity company to share the risk of security provided by the target company. In practice, private equity investors are not willing to provide or share the risk of such security.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

The regular financing documentation for a private equity buyout usually consists of a loan agreement and the security documentation. Security documentation principally involves share pledges and – depending on the complexity of the transaction – assignment of dividend receivables, commercial enterprise pledges, usufruct rights over the shares, deposit pledge agreements, mortgages over real estate or pledges over the goods of the target and escrow agreements. These broad security requests are rarely accepted by international private equity firms, but are more common in acquisition finance by Turkish companies.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Theoretically, in the event of the target's bankruptcy, the target's directors may be accused of fraudulent conveyance where the target's assets secure the acquirer's financing. No precedent, however, exists in Turkey for this type of fraud. Furthermore, the TCC has significantly limited the application of leveraged buyouts under Turkish law and therefore the possibility of such issues occurring becomes even more remote.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Standard provisions of a shareholders' agreement, such as transfer restrictions, board representation, veto rights and option rights, are common features in Turkey. As investors stay for a short time and later exit the company, exit mechanisms such as tag-along and drag-along rights, right of first offer (ROFO), right of first refusal (ROFR) or the initiation of a public offering, which can be major 'deal breaker' issues, are also regulated by shareholders' agreements.

The specific performance of certain provisions, such as transfer restrictions and drag-along rights, may be too cumbersome, unavailable under conventional structures or only achievable after long and arduous proceedings. Such provisions are set forth both in the AoA and shareholders' agreements. Where identical provisions appear in both the shareholders' agreement and the AoA, parallel proceedings are initiated. This is because shareholders' agreements and AoAs are often subject to different laws and dispute resolution mechanisms, such as local litigation and international arbitration. Parallel proceedings further complicate and prolong any resolution of a dispute. Another typical exit provision in shareholders' agreements for private equity investments in non-public companies is the right to exit through an

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IPO, whereby the private equity investor has a preferential right to sell its shares. For listed companies, some actions or provisions bear the risk of being deemed unfair to small investors. With the enactment of the TCC, companies no longer have as much flexibility when entering into shareholders' agreements granting special rights to majority shareholders.

Under the TCC, shareholders representing at least 10 per cent of a company's share capital are deemed minority shareholders, benefiting from a number of rights. As for public companies, a 5 per cent shareholding is deemed a minority shareholding under the CML. Minority shareholders have the right to do the following:

- prevent the release of liability for board members or auditors, or both;
- request the appointment of a special auditor;
- summon an extraordinary meeting and add additional items to the agenda;
- postpone discussions on the balance sheet in a general assembly meeting for one month;
- demand the winding up of the company;
- demand the issuance of share certificates;
- nominate members to the board of directors; and
- demand the replacement of the independent auditor.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

With respect to private companies no requirement exists. According to Communiqué No. 54, if an individual, legal entity, or group of individuals or legal entities acting in concert directly or indirectly acquire the management control of a public company, they must make a tender offer to acquire the remaining shares. See question 3 regarding management control.

In this respect, an application must be made to the CMB within six business days of the acquisition of the shares transferring management control in order to launch a mandatory tender offer. The mandatory tender offer must be initiated within 45 business days of the acquisition, and must remain open for between 10 and 20 days.

The value of the mandatory tender offer must not be less than the highest price paid for the company's shares by the acquirer within six months prior to the acquisition that causes the tender offer requirement; such payments include the acquisition that causes the tender offer obligation. Price adjustment mechanisms, additional payment options and other elements increasing the shares' purchase price that cause the tender offer obligation are also taken into consideration.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

The exit options are generally regulated by means of a combination of put options, call options, tag-along rights, drag-along rights, ROFO or ROFR. Since the specific performance is not recognised under Turkish law, the enforcement of these options is generally secured with conventional penalties or other security mechanisms, such as an escrow or share pledge.

Tag-along rights, drag-along rights, ROFOs and ROFRs, and their pricing and mechanism, are substantially similar to international market practice. With respect to put and call options, either an automatic right is granted upon the lapse of a specific period of time (eg, expiry of the lock-up period) or the options are triggered with events of default (defined as 'material breaches of contract') listed on an item-by-item basis in the shareholders' agreements. Put and call options triggered in the event of default mainly have cure periods and purchase prices designed in a manner to penalise the material default of the defaulting party (eg, lower fair market value for call options or higher fair market value for put options).

An IPO must be channelled through a joint-stock company. With the enactment of the TCC, as transfer restrictions cannot be included in the AoAs of joint-stock companies, it is expected that most private equity investors will prefer to invest through limited liability companies. Therefore, private equity companies are likely to establish a limited liability company that will later be reorganised into a joint-stock company before an IPO is launched.

One other issue that should be kept in mind is the joint-stock company's right to ask that the shares not be transferred to the third-party purchaser that is the intended transferee, but to the target company itself, another shareholder or a third party at a price to be determined by a court as fair value. This provision has been established under the TCC and presents a significant problem for minority shareholders in Turkish joint-stock companies.

Representations and warranties are designed for the benefit of the buyer, to define the target enterprise and determine the seller's liability where the target enterprise is not as represented. Representations and warranties in a share purchase agreement may be structured to serve as contractual penalties to compensate for any shortfall in the buyer's expected benefit from the transaction, and particularly in the event of a seller's breach of representation and warranty or its obligations under call or put options.

An alternative mechanism, escrow, is required when part of the shares or consideration must be set aside for a certain period of time under put, call and other share purchase options or as a security for potential representation and warranty breaches. The escrow agreement should be drafted under Turkish law, whereby an escrow agent is the parties' representative who holds these assets on their behalf. Escrow is typically not a substitute for a pledge; sometimes, however, the escrow agent's authority is elevated to the level of a pledge.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

The most common way to enable an IPO exit is through standard shareholders' agreement provisions, such as board appointment rights, veto rights and transfer restrictions. Another useful provision imposes obligations to support and vote in favour of the IPO process. With the enactment of the new TCC, such provisions cannot be contained in the AoA, but rather in the shareholders' agreement. Further to the new TCC, the heightened protection of minority rights and shareholders' agreements may not harm or limit minority rights in any way.

Under the CML, all capital market instruments that will be publicly offered or issued must be registered with the CMB. Therefore, shares cannot be offered or sold prior to registration. In the event of a violation, the CMB may impose an injunction on the issued shares and sue to annul an unauthorised issuance.

A lock-up period is commonly included to prevent shareholders from trading shares for 90 to 180 days following the first day of trading after an IPO, to protect the post-IPO value of the shares. Unlike European markets, exits from portfolio companies through an IPO are not common in Turkish practice, therefore there is no established practice in this respect, but this trend has started to change with Mediterra Capital's exit from Logo Yazılım through a sale to international investors and Turkven's exit from Mavi Jeans through an IPO. Turkven also launched an IPO for DP Eurasia on the London Stock Exchange. These developments in the past two years have convinced the private equities that an exit through an IPO can also be an option in the Turkish market.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Private equity transactions have not focused on any particular industry or type of company. Investments include the following sectors:

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Update and trends

2016 was a year with a low amount of private equity activity in terms of numbers and especially value of deals, but 2017 has shown some signs of recovery. 2018, however, is expected to witness a meaningful increase in private equity deals as the numerous private equity deals concluded between 2011 and 2013 have reached their exit period and investors will look to use the recovery in the M&A market as an opportunity to realise their exits. Furthermore, the government's efforts to stimulate the economy and ameliorate the investment climate will also contribute to the private equities' ongoing efforts and this synergy may help to see a busy year in the private equity market.

- food and drink (KFC, Yorsan, Mey Icki and Yudum);
- the health sector (Acibadem, Dunya Goz, Medical Park, Universal Hospital, Kent Hospital and Memorial Hospitals);
- retail (SPX, DeFacto, Ziylan, Penti, Koton, Yargıcı and Migros);
- transport (Netlog, MNG Kargo, UN Ro-Ro and Kamil Koc);
- media (Digiturk);
- pharmaceuticals;
- IT (Abraaj's acquisition of a stake in Hepsiburada.com and Biletall.com and Delivery Hero's acquisition of Yemeksepeti.com); and
- real estate.

There appears, however, to be a lack of interest or suitable targets in Turkey's three main industries: financial services (especially banking, but one exception to this is Abraaj's recent acquisition of a minority stake in Fibabanka), textiles and tourism.

There are no specific regulatory provisions preventing private equity firms from entering any sector. Investment in certain sectors, such as the financial services sector, energy and media, however, require disclosure of the ultimate beneficial owners of the shareholders. Therefore, private equity firms may have difficulties in explaining their fund structure. There are also certain thresholds regarding foreign ownership in certain industries, such as radio and television. Private equity firms have attempted to overcome these thresholds by establishing trust relationships with Turkish individuals (yet compliance with the regulations may still be an issue). This approach may not be practical under private equity firms' charters, which may prevent a firm from acquiring shares exceeding the statutory limit. There are also several restrictions on foreign ownership of real estate and vessels, which complicate certain investments.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

Dividend payments to certain offshore jurisdictions popular for fund management, such as Jersey, are subject to a 30 per cent withholding tax in addition to the 15 per cent tax applied to all Turkish dividend payments.

Even though no specific regulatory provision prevents foreign private firms' entry into any line of business in Turkey, disclosure to public authorities is required as to the ultimate (direct and indirect) beneficial owners of the shares in companies conducting certain business activities, such as financial services, telecommunications, energy and media.

In complying with these regulations, private equity investors may have difficulty explaining their fund structures. Moreover, in some industries, such as radio and television, there are certain upper limits on foreign ownership. These thresholds might be overcome by establishing trust relationships with Turkish individuals.

Foreign individuals and legal entities are also partially restricted in the direct and indirect ownership of real property. Foreign entities may purchase real property in limited circumstances under special legislative acts, primarily the Law on Promotion of Tourism, the Petroleum Law and the Law on Organised Industrial Zones. These limitations can be avoided through the establishment of a Turkish legal entity (special purpose vehicle (SPV)) in Turkey, which may even have 100 per cent foreign shareholders. Using a Turkish SPV to purchase property in Turkey is usually realised in one of two ways.

Under the first option, the private equity company incorporates a Turkish SPV, which acquires the real property after obtaining special permission from the regional governorship and other authorities to ensure the property is not in a military zone, private security zone or strategic zone. This procedure is usually completed within one to two months. Once cleared, there are no obstacles to acquiring the real property indirectly through a Turkish SPV. As a further obligation, a Turkish SPV must seek the relevant ministry's approval for a projection of its project concerning real estate property it has acquired without a building (ie, site only) within two years of acquisition. Upon approval, the commencement and completion dates are designated by the relevant ministry, and the approved project is sent to the land registry for project registration. If the project is not submitted to the ministry within two years of the real estate property acquisition, or not completed by the completion date, the real estate property shall be liquidated within a certain time period designated by the Ministry of Finance, which cannot exceed one year. Otherwise, the real estate property will be liquidated by the state, with proceeds from the liquidation sale paid to the right owner, excluding expenses incurred from the sale.

As a second option, real property may be acquired by a Turkish SPV with 100 per cent domestic capital (namely, with Turkish shareholders). After the acquisition, the private equity investor acquires the shares of the Turkish SPV, and thus indirectly acquires ownership of the real property. In this case, a procedure similar to that of the first option is followed. Unlike the first option, however, the procedure commences after acquiring the real property. Therefore, this procedure leads to post-acquisition approval, rather than approval being a condition precedent to the acquisition. The transferee company serves notice to the Ministry of Economy within one month following the acquisition of the shares, indicating the company's shareholding structure has changed and a foreign person has become a shareholder. The Ministry of Economy then notifies the General Directorate of Land Registry and Cadastre. The land registry follows the same procedure used for Turkish subsidiaries with a foreign shareholding (as explained in the first option) and confirms with the regional governorship and other authorities that the real property is not in any military zone. The land must be liquidated within six months if the application is rejected. This term can be extended for an additional six months in case there are reasonable grounds for extension. Otherwise, the land will be sold by the Ministry of Finance.

The restriction on acquiring real property by foreign entities plays an important role, especially for private equity firms investing in manufacturing and retail because of the facilities and premises held by the target companies.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Club deals are common in Turkey (the most recent ones are the acquisition of Ziylan by Turkven, Gozde Girisim and BİM and the acquisition of UN Ro-Ro by Actera and Esas Holding). Although the largest acquisition in the Turkish market so far was a group deal (BC Partners, DeA Capital and Turkven's acquisition of Migros), there are no specific regulations regarding private equity firm club or group deals. The terms of a club agreement should be carefully drafted to comply with local competition law. This risk increases if the target has a concession from the government or enjoys a natural monopoly. In these cases, in the absence of competition in the market, any pre-offer deals may be deemed restrictive by the Competition Authority.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Private equity buyers tend to include vague provisions to their benefit in share purchase agreements that entitle them to easily walk away, such as a condition precedent requiring the private equity buyer to obtain all internal approvals. Given the many private equity deals in the Turkish market, sellers are well aware that a private equity buyer may decline to close the transaction, and sellers often seek to ensure that the share purchase agreement includes no subjective conditions precedent solely for the private equity buyer's benefit.

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Another complication that arises in certain private equity deals is the seller's tendency to renegotiate the financial terms before or after signing. In such cases, the private equity buyer invests in the target jointly with another investor, walks away from the deal or negotiates with the seller to reach financial terms acceptable to both parties.

To ensure a successful closing, private equity buyers include termination fees in share purchase agreements, whereby the sellers must pay termination fees to the private equity buyer if they fail to close the deal.

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

A buyout typically involves acquiring a controlling stake in a business, although there are a significant number of transactions in which a minority interest is obtained. In order to enter into a buyout of a private company the private equity sponsor will incorporate one or more 'newcos' or special purpose vehicles. Funding will be provided in the form of equity (provided by the private equity sponsor and often by existing management) and, in most cases, debt. The inclusion of debt will provide the sponsor with the benefit of 'leveraging' its equity investment.

If the target of a buyout is, or has recently been, a public UK-listed or publicly traded company, the City Code on Takeovers and Mergers (the Takeover Code) will usually apply (see question 4). Where there are many sellers, such as in the case of a listed target, the purchase will take place by way of an offer or, alternatively where the target agrees, by way of a scheme of arrangement under the Companies Act 2006. A scheme of arrangement is, essentially, a court-sanctioned agreement between the company and its shareholders (in this context) pursuant to which all of the shares of the company are transferred to the bidder. Most private equity transactions are purchases of shares in a private company by way of a private sale and purchase agreement. Where the target is a UK company, 'mergers' (ie, where one of the bidders and the target ceases to exist as a result) are generally not available as a transaction structure.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Private companies are required to comply with the provisions of the Companies Act 2006 and associated companies legislation. Public companies are subject to more stringent regulation as are listed public companies. Listed public companies must comply not only with companies legislation but also with the relevant listing, transparency, disclosure and stock exchange rules. For those companies listed on the London Stock Exchange, these regulations will be the Listing, Prospectus, Disclosure and Transparency Rules as well as the Admission and Disclosure Standards. Owing to this increased regulatory burden, private equity sponsors who acquire listed public companies will often seek to delist the target company. Another advantage for sponsors of going private is that they avoid the UK's prohibition on a public company giving financial assistance to purchasers who are acquiring shares in that public company.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

Directors of all UK companies must consider their statutory and fiduciary duties when entering into any transaction. The statutory duties, which to a large extent codify existing common law duties, require directors to act in a way that promotes the long-term success of the company for the benefit of its shareholders as a whole. This duty also requires the directors to consider the interests of the company's employees. Directors also have a duty to use reasonable care and skill, avoid conflicts of interest and declare any direct or indirect interest in the proposed transaction.

For going-private transactions there are additional considerations, in particular those contained within the Takeover Code (where applicable – see question 4 for further information). For example, when exercising their fiduciary duty to promote the success of the company, the Takeover Code provides that price may not be the sole determining factor when directors decide whether or not to recommend a transaction. The Takeover Code provides for six general principles that all parties to a going-private transaction (including the company and its board) must adhere to, as follows:

- that all shareholders in the target are treated equally;
- that all shareholders have sufficient time and information to assess an offer and that the board of the company gives its view on the offer;
- that the board of the company must act in the interests of the company as a whole and not deny the shareholders the opportunity to decide on the merits of an offer (eg, by taking unlawful frustrating action such as 'poison pills');
- that there is no false trading market created in the company's shares;
- that the bidder makes an offer only once he or she can satisfy the offer in full and in cash; and
- that the company must not be hindered for longer than is necessary as a result of any offer.

It is not uncommon for a target company's board to form a special committee of directors to be responsible for the conduct of any bid and such committees will usually be formed of independent directors. This is particularly important where, for example, executive directors or members of senior management are participating in the transaction either by taking a stake in the bid vehicle, rolling over their current interests or being appointed by the private equity sponsor (which may be an existing shareholder). Every director will usually be required to disclose to such a special committee all relevant facts relating to him or herself (and close relatives and related trusts) that may be relevant to the proposed transaction. The Takeover Code does, however, provide that where any such special committee is constituted, appropriate arrangements must be in place to enable the board as a whole to monitor any transaction.

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Any proposed incentivisation arrangement between a bidder and management of a target company is regulated by the Takeover Code. See question 8 for further information.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The Takeover Code will apply to a going-private transaction involving the following:

(i) a company that has its registered office in the UK, Channel Islands or Isle of Man if any of their securities are admitted to trading on a regulated market or a multilateral trading facility in the UK, Channel Islands or Isle of Man;

(ii) any publicly traded company (not covered by (i) or (iii)) or societas Europaea, which has its registered office in the UK and that has its 'place of central management and control' in the UK, Channel Islands or Isle of Man; or

(iii) any company that has its registered office at either of the following:
- in the UK and whose securities are admitting to trading on a regulated market in one or member states of the European Economic Area (EEA) but whose shares do not trade on a UK regulated market;
- in any other member state of the EEA and whose shares trade on a UK but not any other EEA-regulated market; or
- in any other member state of the EEA and whose shares trade on more than one EEA-regulated market but not on a regulated market in the jurisdiction of its registered office. This type of company will also be subject to the Takeover Code.

The disclosure requirements of the Takeover Code apply to a takeover offer and to takeovers effected by English law schemes of arrangement.

The Takeover Code's disclosure regime is intended to provide the market with a greater degree of transparency during the course of a takeover when compared to the disclosure rules applicable at other times. Disclosure can be divided into two sub-sets: offer disclosure and disclosure during the offer period itself. Rule 1(a) of the Takeover Code provides that when the bidder is ready to announce its bid, it must put forward its offer to the target board. This applies to both bids recommended by the target board and hostile bids contested by the target board. Prior to the bidder approaching the target board, rule 2.2 of the Takeover Code provides that where there is rumour, speculation or an untoward movement in the target's share price that can reasonably be attributed to the actions of a potential bidder (whether through inadequate security or otherwise), the Takeover Panel may require the potential bidder to make an immediate announcement stating its intentions. If the bidder accordingly announces that it may make an offer for the target it will be subject to a 28-day 'put-up or shut-up' period by the end of which it must announce that it has a firm intention to make an offer or announce that it will not be making an offer (and, in the event it announces that it will not be making an offer but subject to certain exceptions, it will be prevented from making another offer for a period of six months).

In the event that the bidder announces that it has a firm intention to make an offer it must send a formal offer document to the target's shareholders, or, if a scheme of arrangement is to be used to implement the offer, the target must send the scheme document to its shareholders. The offer document must detail the principal terms of the offer including the bidder's intentions for the target; details of the financing used to fund the acquisition; any irrevocable undertakings (commitments from existing shareholders) and special arrangements or interests that exist between the bidder and the target. Rule 24 of the Takeover Code provides that the offer document (or scheme document) must be sent within 28 days from the date of an announcement of the offer. This document must be sent to the Takeover Panel in electronic form, as well as to target company shareholders and all other individuals who have the right to receive information from the target.

At the commencement of the offer period, the Takeover Code requires all market participants to disclose long and short positions in respect of the shares (and any instruments linked to the shares) of the target if it holds more than 1 per cent of those shares to the Takeover Panel and to a Regulatory Information Service (RIS). Each of the bidder (with respect to the target) and the target (with respect to the bidder) are required to disclose all interests irrespective of size, in the same manner. During the offer period any dealings in the securities of the target must be reported on a daily basis to an RIS and the Takeover Panel.

Notwithstanding the provisions of the Takeover Code, significant shareholdings are required to be disclosed whether or not an offer is being made if the target company is listed on the London Stock Exchange by virtue of the Disclosure and Transparency Rules. If a private equity sponsor wishes to enter into a stake-building exercise for such a target, either before making an offer or post making an offer, then it will be required to comply with such rules and make an announcement of its interest in the target company's securities if, and when, it holds 3 per cent or more and every time it then passes through a percentage threshold, in the case of UK-incorporated issuers, or at 5, 10, 15, 20, 25, 30, 50 and 75 per cent, in the case of non-UK incorporated issuers.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

There are a number of timing considerations to think about for a going-private transaction to which the Takeover Code applies (as detailed in question 4). If the transaction is not subject to the Takeover Code, then there is no formal timetable. There are, however, several points that are common whether or not the Takeover Code applies. The bidder will need to evaluate the likely length of any due diligence process and whether any regulatory approvals will need to be sought.

Transactions to which the Takeover Code applies will have to conform to the strict timetable and procedures set out in its rules. The rules mandate when acceptance levels must be announced, minimum and maximum periods for which the offer must be held open and the earliest date at which the offer may close.

If the transaction is subject to the Takeover Code and is being effected by an English scheme of arrangement the target will have to comply with the requirements of the Companies Act 2006 and book a court directions hearing so that the court can convene a meeting of the target's members to approve the scheme and subsequently book a court sanction hearing so that the court may (at its discretion) sanction the scheme. The Takeover Code applies a modified timetable to a transaction being implemented by way of a scheme of arrangement.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Under English company law there is a 'hierarchy of benefits' contingent on the proportionate amount of shares held in a company. Few of these provide a dissenting shareholder with means to obstruct a going-private transaction other than where their interest is sufficient to block the transaction. The relevant percentages and an explanation of the rights associated with them are set out briefly below:

Total percentage held	Rights that can be exercised
5	Call a shareholders' meeting
10	Require a bidder with 90 per cent of the shares to acquire the remaining 10 per cent
25 plus one vote (or more)	Block a special resolution
50 plus one vote (or more)	Effective control as holder can block or pass ordinary resolutions
75	Pass special resolutions and vary rights attached to the class of share it holds
90	Require minority shareholders with holdings of up to 10 per cent to sell their shares on an offer (known as squeeze-out)
95	Pass special resolutions on short notice (less than 14 days)

Shareholders have the option of not accepting the bidder's offer or voting against a scheme of arrangement. In any offer, once the bidder has

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acquired 90 per cent of acceptances (which for these purposes generally excludes the acceptances of any 'associate' of the bidder) it can squeeze out the remaining dissenting shareholders. Such squeeze-out action can be challenged by the dissenting shareholders before the courts. Minority shareholders have further statutory protection, in the form of derivative actions or unfair prejudice petitions. Exercise of these protections is at the discretion of the court and in any ordinary course transaction would be unlikely to be successful.

A scheme of arrangement must be approved by a majority in number of the company's shareholders voting on the scheme representing at least 75 per cent of the value of the shares voted. A shareholder holding more than 25 per cent of a company's shares can, therefore, block a scheme at the court-ordered shareholder meeting stage. In addition, shareholders who disagree with the proposals also have the statutory right to attend the sanction hearing. They are able to challenge the validity of the scheme, on a variety of procedural grounds, or attempt to delay or 'stay' its implementation.

Activist shareholders have become an increasingly frequent feature in Takeover Code transactions, especially where a scheme is being used, as a blocking stake can be amassed with significantly less than 25 per cent of the target's shares if there are many dormant shareholders who do not vote at the scheme meeting. Further, such shareholders have also considered divesting shares to affiliates in order to try and 'swamp' the initial shareholder meeting and ensure that the 'majority in number' test fails, even though the 75 per cent threshold may be met by the minority in number. The likely success of such a tactic is yet to be tried before the courts.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

In secondary buyouts, sponsors will typically ask existing management for a wide-ranging list of warranties as to the target business as the exiting sponsor is unlikely to give any business warranties. Management will typically try to qualify these warranties by introducing a cap, time limits and a number of other general limitations.

Conditions to closing will typically be very limited, even in private sales (where the conditionality requirements of the Takeover Code do not apply (see question 20)). The purchase agreement needs to be negotiated to work with any financing commitments made by lenders to the sponsor bidder. These may include undertakings to assist with the financing by preparing an offering document for bonds issued to finance the transaction.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

The retention and incentivisation of management is frequently a key part of any private equity buyout or going-private transaction, and management will often be invited to acquire shares in the target or acquisition vehicle that will enable them to participate in a proportion of future equity growth (known as 'sweet' equity). Usually this is under a formal management equity plan set out in the shareholders' or investment agreement and the constitutional documents of the target, and management will typically be separately advised.

The portion of total equity allocated for management as sweet equity will depend on the specific transaction, but is usually around 10–20 per cent. Sweet equity is typically subject to transfer restrictions, a three to five-year vesting schedule, and leaver provisions that determine the price at which management's shares may be bought on or in a period following their departure (known as 'good' or 'bad' leaver provisions). If a 'ratchet' mechanism is included, the economic entitlement of the sweet equity holders increases if certain performance targets are reached. There are a number of different ways that ratchets can be structured. Participation of management in different forms of future exits, including the impact of those exits on unvested sweet equity and the operation of 'tag-along' and 'drag-along' provisions, are always heavily negotiated issues.

As the sponsor will typically make the majority of its investment in the form of shareholder loans (or similar debt or quasi debt instruments in other jurisdictions), the sweet equity will always rank behind those instruments and may also rank behind any shares held by the sponsor. Managers who hold equity in the target prior to the buyout may be able to 'roll over' that investment into the new structure, or may, in addition to their sweet equity allocation, be invited or required to re-invest a portion of their sale proceeds alongside the sponsor in debt or quasi-debt instruments and shares that rank pari passu with, and are on the same terms as, the sponsor (known as the 'institutional strip').

UK tax-paying managers will be keen to ensure that any future equity growth is taxed as a capital gain instead of employment income. Depending on the circumstances, the sponsor may consider a structure that accommodates entrepreneur's relief planning or employee shareholder status.

There are additional considerations if management already holds shares or outstanding share-incentive awards in the target and the Takeover Code applies to the transaction (see question 4). The bidder is required to treat all shareholders of the target in the same way (ie, no special treatment can be given to existing management shareholders) and the principle of equal treatment also applies to holders of options or other share-incentive awards, to whom a bidder must, under rule 15 of the Takeover Code, make an 'appropriate' offer or proposal. Furthermore, if the sponsor has entered into or reached an advanced stage of discussions on incentivisation arrangements with pre-existing management shareholders, rule 16.2 of the Takeover Code requires details of such arrangements to be disclosed and an independent adviser must opine on whether the arrangements are 'fair and reasonable'. In certain circumstances, prior consent of the Takeover Panel and the independent target shareholders is required. While it is rare for the Takeover Panel to withhold its consent for these arrangements it may, in certain circumstances, require that such incentivisation arrangements (if significant or unusual) be approved by the target company's independent shareholders. Where no incentivisation arrangements are proposed, this must also be stated publicly.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The principal tax issues fall into four broad categories, as follows:

- transaction tax costs of the acquisition;
- the tax profile of the target group (including its historic tax risks) and the extent to which it is possible to obtain and use tax deductions for the costs of acquisition finance;
- tax-efficient incentivisation of management; and
- preparing for a tax-efficient exit.

We cover below a high-level summary of some aspects of these issues as they relate to an acquisition of a UK target company by a UK newco. Many other tax issues are likely to be relevant and full due diligence and tax structuring should be undertaken in light of the particular circumstances. In many private equity transactions it will also be necessary to consider tax rules in other jurisdictions, including in all countries where the target operates and where the sponsor or fund investors are based.

The main transaction tax cost of the acquisition of shares in a UK company will be a UK stamp duty charge, payable by newco, of 0.5 per cent of the consideration. An acquisition of shares in a UK company does not attract VAT. Although most costs incurred by a UK newco that relate to the acquisition (such as adviser fees relating to the share acquisition) will not be immediately deductible for UK tax purposes, they may form part of the capital gains tax base cost and therefore reduce the newco's chargeable gain upon exit. It may be possible to recover some VAT incurred on transaction costs, although the position is complex and detailed advice would need to be taken.

Certain costs relating to acquisition finance (including interest expense) may be deductible under the UK rules on the taxation of loan

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relationships. To the extent such deductions are available, they may give rise to losses that can be surrendered to the target company (under the UK's 'group relief' rules) to shelter its operating profits. A private equity sponsor will often also consider whether, in addition to third-party acquisition finance, it will be possible to generate further deductible interest expense by introducing shareholder loans. Under current UK tax law there are various rules limiting the availability of tax deductions for interest and other finance expenses. In the case of shareholder loans, these include transfer pricing rules that limit deductible interest to an arm's-length amount. It should be noted that in response to the Organisation for Economic Coooperation and Development's Base Erosion and Profit Shifting initiative, the UK government is now considering further restrictions on interest deductibility under which permissible net interest deductions would be limited to a fixed ratio of profits of the borrower entity or its group.

Interest on acquisition debt or shareholder loans is subject to 20 per cent UK withholding tax, unless an exemption or reduced rate applies. An exemption may apply if the lender is within the charge to UK corporation tax. An exemption or reduced rate may apply if a non-UK lender qualifies for relief under a double tax treaty with the UK. Alternative exemptions under domestic UK law that may be considered include the 'quoted eurobond' exemption for debt listed on a recognised stock exchange or the recently introduced 'private placement' exemption. Dividends paid by UK companies are not subject to UK withholding tax.

As discussed in question 8, the management team may participate in the equity of the target group. As a general rule, the acquisition of shares by management should not be taxable provided the shares are acquired for full value for UK tax purposes. The UK tax authorities and the British Private Equity & Venture Capital Association published a 'memorandum of understanding' in 2003 in relation to management participation and, where the conditions in that memorandum are complied with, the UK tax authorities generally accept that the price paid by management for their shares is equal to the full value for UK tax purposes. It is common practice, therefore, for management to request that the incentive package is structured in accordance with this memorandum. Upon exit, where the relevant conditions are satisfied, management may be able to benefit from a reduced rate of capital gains tax under the UK's entrepreneur's relief rules. In recent years management employees receiving at least £2,000 worth of shares in their employer (or a parent company of their employer) have, in return for giving up some statutory employment rights, also sought to benefit from relief from capital gains tax on the disposal of the shares under rules relating to 'employee shareholders'.

It is important that the tax implications of potential exit scenarios are considered when establishing the acquisition structure. Where an exit is at the level of a UK newco, relief from UK tax on capital gains may be available under the UK's participation exemption (the 'substantial shareholding exemption') provided that certain conditions are satisfied. Unlike participation exemption regimes in other jurisdictions, the relevant conditions look to the activities of the target and the seller, not merely minimum shareholding requirements. If the UK newcos are owned by a non-UK resident parent company, it may be preferential for the parent company to be the seller since the UK does not have a non-resident capital gains tax on share sales. Other relevant matters to be considered from the outset include the tax treatment of management on exit, and of holders of carried interest in the private equity fund. There are also likely to be tax implications of any pre-sale restructuring, including, for example, the insertion of a new parent company in anticipation of an IPO.

Transactions structured as share acquisitions by newco cannot be classified as asset acquisitions for UK tax purposes.

10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Private equity sponsors use a variety of methods to finance their acquisitions. The nature of the financing used will, to a large extent, depend on the sort of transaction that the private equity sponsor is entering into (for example, the acquisition of a whole or just minority interest), as well as its ability to draw on its own reserves to finance the deal. In the first instance there may be existing indebtedness at the target company level. The sponsor will have to look at the terms of the existing indebtedness and specifically at the repayment schedule, any mandatory prepayment events (such as those triggered by a change of control) and whether additional leverage can be incurred under existing leverage baskets. Typically, leveraged buyouts will require refinancing of the existing debt of the target group, which will be acquired 'cash free and debt free'.

Senior bank debt will be provided in the form of a syndicated facilities agreement that would usually include a term loan A, term loan B and a revolving credit facility which will be repayable and amortise differently. Term loans A, which are typically amortising, have been less common in recent times with private equity sponsors preferring the bullet repayment profile of term loans B. Banks will be required to undertake credit assessments on the target and its prospects so bidders should factor this into their consideration of transaction timing. Facilities of this type will be secured against the target's assets. The facility documentation will also include a fairly restrictive negative pledge and positive and negative covenants. Financial covenants will mainly be on a maintenance basis unless the deal is a true 'cov-lite' deal in which case the financial covenants will be tested only when debt is incurred rather than every quarter. Senior secured debt is now often provided in the form of senior secured notes or bonds either alongside or instead of senior secured loans.

Additional leverage may come from more junior forms of financing: mezzanine debt, second lien debt and subordinated or unsecured high yield debt or payment in kind (PIK) notes. Mezzanine debt will rank behind the senior debt and will consequently bear a higher interest rate to reflect this risk. Second-lien debt or second-lien notes will rank between the senior bank debt and more junior debt. PIK notes are instruments that can be issued whereby interest payments are paid in kind (ie, by way of additional loans or notes) rather than in cash.

Unitranche loans have also been used for recent mid-market transactions. A unitranche loan replaces both the senior secured debt and junior debt with a single layer of debt, provided at a 'blended' interest rate that a private equity sponsor might otherwise pay in a senior secured debt and junior debt structure. These are provided by direct lenders, typically the lending arm of a fund rather than a traditional bank. A unitranche deal may involve a single lender or multiple lenders. Where there are multiple lenders, the lenders may agree to apportion the loan and interest allocation between themselves with an 'agreement among lenders'.

As mentioned in question 2, there are special rules relating to financial assistance under the Companies Act 2006. Under this regime it is unlawful for a public company to provide financial assistance for the purchase of its own shares or the shares of the private holding company of a public company. Financial assistance has been broadly interpreted to include guarantees, indemnities and other quasi-security arrangements. Where the target is a public company it will be reregistered as a private company to be able to give guarantees and security.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Where the Takeover Code applies to a transaction a bidder will have to announce that it can fulfil any cash consideration (or a cash alternative if this is offered) in full. This principle, known as 'certain funds' is common to private equity transactions in many European jurisdictions. In going-private deals in the UK the conditions to bid financing are prescribed by the Takeover Code. Where an offer is for cash or includes an element of cash consideration the sponsor bidder's financial adviser must confirm (and make a statement to that effect) in the offer document that resources are available to the bidder to satisfy full acceptance of the offer. This statement by the financial adviser will rarely be provided until the financial adviser has received the sponsor's equity commitment letter, lenders' commitment letters, has completed its

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own due diligence and the conditions precedent to the lender's commitment papers have been satisfied.

There will, of course, be a gap between a lender (or indeed the underwriters who plan to syndicate the debt if the transaction progresses) initial commitment to fund and the transaction closing.

At the time an offer is announced or a binding bid is made in a private company auction process, the documentation will likely be very advanced, including an equity commitment letter and certain funds financing commitments in the form of full facility documentation or an 'interim facility agreement', which is capable of being drawn to fund the transaction along with an executed commitment letter that includes a term sheet for the full facility documentation.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Transactions that are entered into by the directors of the target company in breach of their statutory and fiduciary duties may be voided or subject to challenge under English common law principles and statutory provisions.

English insolvency law (primarily the Insolvency Act 1986) will seek to unwind certain transactions entered into by the insolvent company in the period leading up to the commencement of insolvency. Transactions at an undervalue, unlawful preferences and transactions to defraud creditors can be unwound for a period of up to two years if the transaction was entered into with a 'connected' person (which has a specific statutory definition) or six months if with others. Transactions involving the avoidance of floating changes can be unwound for a period of up to two years if the transaction was entered into with a connected person or 12 months if with others.

In a private equity context, the above could relate to guarantees, indemnities and other types of quasi-security that are provided by the target or subsidiaries to the bidder or persons providing financing for the transaction.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

The shareholders' agreement, also called the investment agreement, will set out the terms on which the sponsor will make its investment. Understandably the sponsor will want to exert a significant amount of control over the target. Typically, the shareholders' agreement and the target's articles of association (which will be revised or drafted afresh by sponsor's counsel) will provide the sponsor with 'veto' rights over certain 'reserved matters'. These rights will delineate the decisions that can be made by the management on a day-to-day basis and those that have to be referred to the sponsor. The nature of this agreement will depend on how much discretion the sponsor is willing to give the management, but such veto rights will extend to acquisitions and disposals by the target; transactions outside the ordinary course of business and the right to conduct any litigation or arbitration on behalf of the target. The reserved matters will enable the sponsor to prevent certain actions from being taken by the board without the sponsor's prior approval.

Where a minority interest is acquired by the sponsor or several sponsors invest together it will be important to build in 'deadlock' provisions in the shareholders' agreement. Deadlock refers to situations where shareholders cannot agree on a major issue. These clauses can be drafted in a number of ways but it is common for the matter on which there is deadlock to be escalated by referral to the senior management of the parties or an independent third party, such as an arbitrator or expert before shareholders are allowed to terminate the shareholders' agreement or for one party to sell their stake to another. It is also important to draft mandatory transfer ('drag' and 'tag') provisions and 'call rights' (where one party can sell) or 'put rights' (where one party can buy) the stake of another. A metric to determine the valuation of such rights will also need to be included in the documentation.

Legal protections for minority shareholders (also outlined in question 6) are incorporated into the Companies Act 2006. A shareholders' agreement may not, as a matter of company law, modify certain statutory provisions, for example, the requisite percentage required to pass a special or ordinary resolution though a shareholder may be able to enforce any agreement made in a shareholders' agreement contractually. In addition, shareholders may bring derivative actions in the name of company if they feel that the company has been wronged but the directors refuse to bring such an action. The requirements to prove a derivative action are fairly onerous, which explains the paucity of applications that have been considered by the courts since the new regime was introduced in 2006. Shareholders may bring a statutory unfair prejudice claim if they believe that the business of the company is being conducted in a way that is unfairly prejudicial to its members. In practice, however, a successful unfair prejudice claim will be remedied by a purchase order forcing the wrongdoer to purchase the minority shares.

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Stakebuilding is the strategic purchase of shares in the target by the bidder. If the Takeover Code applies, the bidder and parties acting in concert with it will be required to make a mandatory offer to each shareholder of the target upon it acquiring shares that carry 30 per cent of the voting rights in that company (other than via a formal takeover offer). A mandatory offer is required to be made in cash (or a cash alternative) and at a price that is equal to the highest price paid by the bidder for any shares in the 12 months before the announcement of the mandatory offer.

A bidder must also be alert to the market abuse rules prescribed under the Financial Services and Markets Act 2000. Currently, however, purchases of a target company's shares by a bidder with knowledge that it is considering making an offer for that target should not fall foul of such rules provided that such purchases are made for the purpose of gaining control of that company.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

The commercial limitations on the choice and timing of an exit strategy in the UK are common to most jurisdictions. Legal aspects to be considered are the restrictions on the transfer of shares in the company's memorandum or articles of association; any pre-existing shareholders' agreements and whether 'drag-along' and 'tag-along' provisions will apply.

If an IPO is chosen (as discussed in question 16) a prospectus will probably be prepared in accordance with the rules of the relevant stock exchange and listing authority. If a prospectus is prepared then liability may arise for the existing private equity sponsor based on the information disclosed in that document. Additionally, the underwriters will require the private equity sponsor to enter into a 'lock-up' agreement in relation to any retained stake. The underwriting agreement will also require warranties as to title, authority and capacity of the private equity sponsor.

In a sale to a corporate or upon a secondary buyout the private equity sponsor will resist giving warranties (save as those to title, authority and capacity). Existing management will have given warranties to the private equity sponsor on acquisition so it is likely that they will, if they are remaining in post, be persuaded to give similar warranties again. Alternatively escrow arrangements, warranty and indemnity insurance and further financial incentives may be used.

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16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

The private equity sponsor will want certain rights over the company after its IPO. Where the offering is listed on the premium segment of the London Stock Exchange and the sponsor and its associates retain a significant shareholding (usually more than 30 per cent) a relationship agreement will be need to be executed. It is common practice to produce such a document when listing on AIM as well. Any agreement will be required to contain undertakings as to the independence of the company and to ensure that it trades on an arm's-length basis with significant shareholders to comply with the Listing Rules. Additionally, the Listing Rules require that if a company has such a significant shareholder the appointment of any director who is to be considered an independent director must be approved by the shareholders of the company as a whole and the shareholders of the company excluding the significant shareholder. That being said, there are no legal restrictions on rights (such as board appointment rights or veto rights for board representatives) that may subsist after an IPO and the ability for the private equity sponsor to retain such rights will largely depend on their retained equity stake, the requirements of the Listing Rules, UK Corporate Governance Code (in each case if applicable) and any negative marketing implications foreseen by the underwriter.

A lock-up agreement may be contained in the body of the underwriting agreement but more likely will be a separate standalone document. It will prohibit the sponsor from disposing of its retained interest in the business without the underwriters' consent. Some agreements will be more restrictive in preventing the sponsor from engaging in any similar dealings (ie, derivatives transactions). The length of the lock-up period will also be heavily negotiated. There is no market standard, but typically these lock-ups last for between six and 12 months. The purpose of the lock-up is to give investors comfort that the shares sold in the IPO will not fall in value owing to large sales of shares not sold in the IPO.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

The UK market has continued to remain popular among sponsors within the European context. There continues to be great sector diversity in the deals that are coming to the market. However financial services, information technology as well as consumer and retail businesses remain strong areas.

There may be additional due diligence, regulatory and timing considerations for private equity sponsors looking to invest in the financial services, consumer credit and energy sectors of the market.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

The takeover regime does not have a specific set of rules that apply to cross-border investments by private equity sponsors. However, the Enterprise Act 2002 does provide the power for the Secretary of State for Business, Innovation and Skills to intervene in certain takeovers or transactions. This 'public interest test' applies to companies that operate in national security, media and broadcasting and financial stability sectors.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

There is no specific legislation or regulation relating to the participation of multiple private equity firms in a club deal. However, the impact of bidders clubbing together and sharing information and due diligence will need to be considered in particular in the context of antitrust or competition laws. Additionally, club deals may trigger the concert party rules of the Takeover Code that attribute the actions of one member of a concert party to other members. If, for example, the bidder, together with parties acting in concert with it, acquires shares that together represent more than 30 per cent of the target then it will be required to make a mandatory offer for the target.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Where a transaction is subject to the Takeover Code, the conditions to closing on which a bidder can rely on are in practice very few, such as competition or other regulatory approvals or, in the case of an offer, a minimum number of acceptances (ideally 90 per cent to enable squeeze-out and facilitate financing, but sometimes lower percentages such as 75 or 50 per cent). The limited conditionality required for offers subject to the Takeover Code are often seen in private purchase agreements and 'financing outs' (ie, where the purchaser's commitment to close is subject to obtaining the required financing) are very rare. This means that the conditions to the financing have to be tailored to the conditions to the completion of the sale of the target's shares. The ability of a public company to pay termination fees is restricted by financial assistance rules. If the transaction is subject to the Takeover Code then break fees payable by the target are generally prohibited.

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1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

US private equity transactions may involve the acquisition by a private equity sponsor of a controlling stake in a private or public company, which is typically structured as a stock purchase, asset purchase, merger, tender offer or leveraged recapitalisation. Private equity sponsors may also make minority investments in public or private companies, which typically involve the purchase of common stock, preferred stock, convertible debt or equity securities, warrants or a combination of such securities. Private equity transactions involving the acquisition of a private or public company are generally structured as leveraged buyouts (LBOs) in which a significant amount of the purchase price is paid with the proceeds of new debt; this debt is usually secured by assets of the target company and serviced from its cash flows. In acquisitions of a public company, a private equity sponsor may engage in a going-private transaction, which typically involves a one-step transaction via a merger or a two-step transaction involving a tender offer followed by a merger. As discussed in question 4, going-private transactions that are subject to rule 13e-3 of the US Securities Exchange Act of 1934 generally require significantly greater disclosure than other types of private equity transactions.

Private equity funds typically create one or more special purpose shell acquisition vehicles to effect an investment or acquisition, and commit to fund a specified amount of equity capital to the acquisition vehicles at the closing. Various considerations dictate the type and jurisdiction of organisation of an acquisition vehicle, including, among others, tax structuring issues, desired governance structure, number of equity holders, equity holders' (and the private equity sponsor's) exposure to liability by use of the applicable vehicle, general ease of administration and any applicable regulatory requirements.

Private equity funds may seek out add-on acquisitions whereby one of the private equity fund's existing portfolio companies acquires a target company in the same or an adjacent industry. This combination allows private equity sponsors to tap into scale opportunities and revenue and cost synergies, which may increase the valuation of the overall combined portfolio company. These factors in turn may enhance returns for the fund's investors in a shorter time horizon than what could otherwise be obtained through natural growth of the original portfolio company. Add-on acquisitions may be financed by a variety of means, including existing cash on the portfolio company's balance sheet, additional equity financing from the private equity fund and/or third-party debt financing. Private equity funds considering an add-on acquisition should be mindful of the considerations typically inherent in strategic acquisitions, including possible enhanced regulatory and/or antitrust scrutiny and potential integration issues following the closing of the transaction.

2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act) and related Securities and Exchange Commission (SEC) and stock exchange rules raise a variety of issues relevant to private equity transactions, including the following:

- if the target company in a private equity transaction continues to have common equity listed on a national stock exchange, subject to certain exceptions discussed below, a majority of the target's board of directors, audit committee, nominating or corporate governance committee and compensation committee must meet stringent independence requirements;
- the New York Stock Exchange and Nasdaq Stock Market do not require 'controlled companies' (namely, companies in which more than 50 per cent of the voting power is held by an individual, group or another company) to maintain a majority of independent directors on the board or have a nominating or compensation committee comprised of independent directors; however, controlled companies are still required to maintain an audit committee comprised entirely of independent directors, and following implementation of reforms pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, a compensation committee is required to meet enhanced independence standards, which have been adopted by the New York Stock Exchange and the Nasdaq Stock Market;
- in conducting due diligence on a public target, private equity sponsors must carefully review the target's internal financial controls, foreign corrupt practices and anti-bribery law compliance and prior public disclosures to evaluate any potential liability for past non-compliance and to avoid stepping into a situation in which significant remedial or preventive measures are required;
- if a private equity sponsor requires management of a public target to purchase equity of the target or a new vehicle formed in connection with the transaction, the sponsor should be aware that a public target is generally not permitted under section 402 of the Sarbanes-Oxley Act to make loans or arrange for the extension of credit to any directors or officers of the target to fund such purchases;
- if a sponsor intends to finance a transaction with publicly traded debt, following the issuance of such debt, the target must have an audit committee comprised entirely of independent directors and must comply with enhanced disclosure requirements (eg, the target must disclose any off-balance sheet arrangements); and
- if a private equity sponsor intends to exit an investment following an initial public offering (IPO) of the target's stock, the exit strategy must take into account the time, expense, legal issues and accounting issues that may arise in connection with the target becoming a public company.

A number of public companies consider going-private transactions in light of the stringent corporate governance regime and scrutiny of accounting and executive compensation policies and practices that

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apply to US public companies. Companies that do not have publicly traded equity or debt securities are exempt from complying with the corporate governance rules in the Sarbanes-Oxley Act and related SEC and stock exchange rules. Some of the other advantages of a going-private transaction include the reduction of expenses relating to compliance and audit costs, elimination of public disclosure requirements, decreased risks of shareholder liability for directors and management and the flexibility provided for long-term strategic planning without the focus on quarterly earnings by public investors. Going-private transactions can also help avoid the risk of activist investors seeking to replace directors or implement other corporate governance or strategic changes.

3 Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

When the board of directors (or any special committee thereof) of a public company reviews a going-private or private equity transaction proposal, the directors must satisfy their fiduciary duties, as would always be the case, and their actions must satisfy the applicable 'standard of review' under the law of the state of organisation of the target company, which may affect whether the directors could be personally liable in any lawsuit that challenges the transaction. In addition, there are various disclosure issues to be considered by the board of directors in considering a going-private or private equity transaction proposal. Generally, before the target company discloses confidential information regarding itself to a prospective private equity sponsor, management of the target company will consult with the board of directors and the target will enter into a confidentiality agreement, which may include additional important terms with respect to the sponsor, such as an employee non-solicitation provision and a 'standstill' provision that prevents the sponsor and its affiliates from acquiring or making proposals to acquire any securities of the company without the board's prior consent. Note that, under US securities laws, a sponsor and its affiliates may be restricted from acquiring securities of a public company if the sponsor or its affiliates are in possession of material, non-public information with respect to such company whether or not a standstill is in place. Also, as discussed in question 12, boards of directors must consider fraudulent conveyance issues presented by the incurrence of any proposed debt by the target company in connection with the private equity transaction.

A critical threshold determination to be made by a board of directors regarding its consideration of a going-private or private equity transaction proposal is whether the board should form a special committee of directors to consider and make decisions with respect to the proposed transaction. Under Delaware law (the leading US corporate jurisdiction), if, for example, a controlling shareholder or a majority of the board of directors has a conflict of interest with respect to the going-private or private equity transaction proposal (in other words, if they are on both sides of the transaction or expect to derive a personal benefit from it), Delaware courts reviewing the transaction will apply the 'entire fairness' standard. The entire fairness standard places the burden of proof on the board to show that both the transaction process and the resulting transaction price were fair to the disinterested shareholders. In the event that a transaction could be subject to the entire fairness standard, a board of directors will typically form a special committee comprised entirely of disinterested directors to shift the burden of proof to any person who legally challenges the transaction. Generally, best practice would also result in the special committee having the right to engage its own financial adviser and legal counsel and being authorised to independently negotiate and evaluate the transaction as well as strategic alternatives on behalf of the target company, including pursuing other acquisition proposals or continuing to operate as a stand-alone company. The board can also shift the burden of proof under entire fairness to a person challenging the transaction by conditioning the transaction on the approval of a majority of the outstanding shares owned by disinterested shareholders (known as a 'majority of the minority' vote). Through recent case law, Delaware courts have developed a roadmap that parties can follow to avoid entire fairness review altogether and instead become subject to the more deferential 'business judgment' standard of review. To obtain business judgment review, a going-private transaction with a controlling shareholder must be subject to both the approval of a special committee of independent directors that is fully empowered to select its own advisers and veto the transaction and the approval of an uncoerced, fully informed majority of the minority vote. Under business judgment review, Delaware courts generally will apply the principle that they should not second-guess the decisions of impartial decision-makers with more information (in the case of the board of directors) or an economic stake in the outcome (in the case of the disinterested shareholders) and will apply a presumption that the action taken was in the best interests of the company.

4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

Generally, going-private transactions and other private equity transactions involving a public target are subject to the same disclosure requirements under the US securities laws that are applicable to other merger and acquisition transactions. However, certain going-private transactions are subject to rule 13e-3 of the US Securities Exchange Act of 1934, which mandates significantly greater disclosure than is ordinarily required by the federal proxy rules or tender offer rules. Generally, rule 13e-3 will apply only if the going-private transaction involves a purchase of equity securities, tender offer for equity securities or proxy solicitation related to certain transactions by the company or its affiliates (which includes directors, senior management and significant shareholders); and if it will result in a class of the company's equity securities being held by fewer than 300 persons or a class of the company's equity securities listed on a stock exchange to no longer be listed. The heightened disclosure requirements applicable to going-private transactions subject to rule 13e-3 include, among other items, statements by the target company and other transaction participants as to the fairness of the transaction to disinterested shareholders, plans regarding the target company, alternative transaction proposals made to the target company, disclosure regarding control persons (eg, information about directors and officers of private equity sponsors) and information regarding the funding of the proposed transaction. Also, the target company will need to publicly file or disclose any report, opinion or appraisal received from an outside party that is materially related to the transaction and any shareholder agreements, voting agreements and management equity agreements.

If the going-private transaction (whether or not subject to rule 13e-3) is structured as a tender offer or transaction requiring the vote of the target company's shareholders (eg, a cash or stock merger), the company's shareholders will be required to receive a tender offer disclosure document or a proxy statement or prospectus containing disclosure that satisfies the applicable US tender offer rules, proxy rules or Securities Act requirements (these generally require disclosure of all material information relating to the offer or transaction). In addition, a target company's board of directors effecting a going-private or other private equity transaction must still comply with any applicable state law requirements. For example, the Delaware courts are increasingly requiring additional disclosure in proxy and tender materials disseminated to shareholders with respect to prospective financial projections and forecasts that the target company has shared with the private equity sponsor.

5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

Timing considerations for a going-private or other private equity transaction depend upon a variety of factors, including:

- the time necessary for the target company's board or special committee to evaluate the transaction proposal and any alternative proposals or strategies;
- the first date on which public disclosure of any proposal to acquire a public company target must be made if the proposal is being made by any person who has an existing Schedule 13D or 13G filing;

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- the time necessary for arranging the acquisition financing, including the syndication of bank financing, sales of debt securities, tender offers or consent solicitations relating to existing debt securities and any attendant delays;
- the time necessary for US and/or foreign regulatory review, including requests for additional information from antitrust or other regulators;
- the magnitude of disclosure documents or other public filings and the extent of SEC review;
- timing relating to solicitation of proxies, record dates and meeting dates in connection with a shareholder vote;
- timing relating to solicitation of tenders and other required time periods under the US tender offer rules (eg, tender offers must remain open for a minimum of 20 business days);
- the risks of significant litigation related to the transaction; and
- the time necessary to establish alternative investment vehicles and special purpose vehicles or to complete a restructuring of the target company prior to closing.

6 Dissenting shareholders' rights

What rights do shareholders have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Although the details vary depending on the state in which a target company is incorporated, in connection with a going-private transaction of a Delaware corporation, shareholders who are being cashed out (including pursuant to a second-step merger following a first-step tender offer) may petition the Delaware court of chancery to make an independent 'appraisal' of the 'fair value' of their shares in lieu of accepting the consideration they would otherwise receive in the going-private transaction. Both the dissenting shareholders seeking appraisal and the target company must comply with strict procedural requirements under Delaware law and the record owners of the dissenting shares must demonstrate that they did not vote such shares in favour of the transaction. Such shareholder appraisal actions can be costly for the acquirer (including as a result of the imposition of a statutorily designated interest rate on the value of the dissenting shares) and often take years to resolve. To the extent that there are a significant number of shares for which shareholders are seeking appraisal, it will create a potentially unknown contingent payment obligation many years post-closing, which may complicate the acquirer's financing depending on how the transaction is structured. As such, some acquirers seek the inclusion of a closing condition in the acquisition agreement providing for the maximum number of shares for which appraisal may be sought; however, such appraisal conditions are not commonly found in acquisition agreements following competitive auctions. Recent judicial decisions in Delaware support the view that deal price may be the best evidence of fair value, a development that may diminish the frequency of appraisal claims in merger transactions.

7 Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

Historically, to the extent private equity sponsors required third-party financing to complete a transaction, they negotiated for the right to condition their obligation to consummate the transaction upon their receipt of the financing proceeds. Current market practice, however, is that private equity buyers typically agree to buy companies without the benefit of a financing condition but instead have the right to pay a 'reverse termination fee' to the sellers as the sole remedy of the sellers or target company against the buyer in the event that all of the conditions to closing have been satisfied (or are capable of being satisfied on the applicable closing date) and the buyer is unable to obtain the third-party debt financing necessary to consummate the transaction. Because the acquisition vehicle that is party to the transaction is almost always a shell entity (and, as such, is not independently creditworthy), target companies typically require the acquisition vehicle's potential obligation to pay a reverse termination fee to be supported by a private equity fund limited guarantee. In addition, target companies often require a limited right to enforce the 'equity commitment letter' provided by the private equity fund to the acquisition vehicle, pursuant to which the fund commits to provide a specified amount of equity capital to the acquisition vehicle at closing. Most purchase agreements providing for a reverse termination fee include provisions that deem payment of such fee to be liquidated damages and otherwise cap the private equity fund's liability exposure to an amount equal to the reverse termination fee amount. Particularly in transactions involving third-party financing, private equity firms rarely agree to a full specific performance remedy that may be enforced against the private equity sponsor's fund or special purpose acquisition vehicle used in the transaction.

In addition to the circumstances above, participants on the other side of a private equity transaction (whether sellers or buyers) will frequently require evidence of the creditworthiness of any special purpose acquisition vehicles used in the transaction to ensure they have a sufficient remedy in the event that the acquisition vehicle breaches its obligations under a purchase agreement or is required to satisfy an indemnification obligation. Participants in private equity transactions may attempt to negotiate guarantees, equity commitments or other support arrangements from a private equity sponsor, but most private equity sponsors resist indemnification, guarantee or other obligations that permit recourse directly against the private equity fund. However, as described above, in circumstances where a sponsor has agreed to pay a reverse termination fee, private equity funds frequently agree to provide a limited guarantee of the payment of the reverse termination fee or may provide the target company with a right to specifically enforce the equity commitment letter from the private equity fund to the extent of the reverse termination fee.

Both sellers and buyers in private equity transactions will generally seek to obtain fairly extensive representations, warranties and covenants relating to the private equity sponsor's equity and debt-financing commitments, the private equity sponsor's obligation to draw down on such financing and obtain any required alternative financing and the target company's obligation to assist with obtaining the financing and participating with any required marketing of the financing. These types of provisions, as well as various other financing-related provisions, are discussed further in question 11.

8 Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity buyer should discuss management participation following the completion of a going-private transaction?

In a private equity transaction, the management of a target company may be offered the opportunity (or may be required) to purchase equity of the target company or the acquisition vehicle, which investment may be structured as a 'rollover' of such management's existing equity holdings. Whether and to what extent such investments are made may depend heavily on the type and amount of the management's historic compensation arrangements as well as the amount, if any, of cash payments management will receive in the going-private transaction, in respect of current equity and equity-based awards and payouts under deferred compensation and other plans. In connection with such investment, management typically also receives equity incentive awards (eg, stock options in a corporation or profits interests in a partnership). These equity awards generally become vested based upon continued employment, the achievement by the company of specified performance targets, the private equity sponsor achieving a particular return on its investment or a combination of the foregoing conditions. These agreements also typically provide for repurchase or forfeiture of the equity incentive awards upon a termination of employment and, in some circumstances, may provide for full or partial acceleration of vesting (the acceleration, repurchase or forfeiture depends upon the circumstances for the termination of employment) and often impose on the employees post-termination covenants not to compete with, or disparage, the company and not to solicit company employees or clients. All equity acquired by an employee will typically be subject to an equityholders' agreement, which customarily includes transfer restrictions, a repurchase right held by the company upon the employee's termination of employment for any reason (with the price varying based on the circumstances for the termination), drag-along and tag-along rights (which are described in question 13) and, in some cases,

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piggyback registration rights. Customary terms of shareholders' agreements are discussed in question 13.

Historically, one of the key concerns in private equity-led going-private transactions has been continuity of management under the theory that sponsors do not have the time, resources or expertise to operate the acquired business on a day-to-day basis. As such, the principal executive compensation issues in a private equity transaction relate to ensuring that equity-based and other compensation has been appropriately structured to provide an incentive to management to increase the company's value and remain with the company following the closing. To this end, primary questions involve whether management may rollover existing equity on a tax-free basis as part of their investment, the accounting and tax treatment (both for the company and management) of equity incentive awards and other compensation arrangements, and to what extent management can achieve liquidity under their investment and equity awards. It should also be noted that other issues, such as ongoing employee benefit protections (eg, post-termination welfare and pension benefits) and certain compensation arrangements (eg, base salary and annual cash bonus opportunities), will factor into any private equity transaction negotiation with management of the target company.

As described above, management participating in a private equity transaction may have several opportunities to earn significant value (both in the primary transaction and upon a successful future exit event). As a result, shareholders of a public company engaged in a going-private transaction are particularly concerned about conflicts between management's desire to complete a transaction or curry favour with the private equity buyer, on the one hand, and shareholders' desire to maximise value in the going-private transaction, on the other. In recent years, this issue has received significant attention, resulting in some boards of directors restricting their senior management from participating in certain aspects of going-private transaction negotiations or discussing post-closing compensation arrangements with the private equity firm until after the price and material terms of the sale have been fully negotiated with the private equity firm and, in some cases, the transaction has been consummated. In addition, in circumstances where a target company has negotiated the right to conduct a post-signing market check, or 'go-shop', or where an interloper has made an unsolicited acquisition proposal after signing that the board of directors of the target believes may result in a superior transaction for its shareholders as compared to the transaction entered into with the private equity firm, the target board may further restrict its senior management from participating in negotiations or discussions regarding post-closing compensation arrangements with all bidders, including the private equity firm, until the final winning bidder is agreed upon. Given the importance to private equity firms of the continuity of management and the structure of their equity and compensation-based incentives, which they often prefer finalising before entering into a going-private transaction, there is often a tension between the time when the board of directors of a target company will permit its senior management to negotiate such arrangements with a potential private equity buyer and when such a private equity buyer desires to have such arrangements agreed upon with such senior management. In addition, the SEC has required significant disclosure regarding management's conflicts of interests, including quantification of the amount to be earned by executives of the target company in the transaction.

9 Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

Many US private equity funds are structured as limited partnerships or limited liability companies, which are generally treated as pass-through entities for US tax purposes. Private equity transactions can sometimes be structured such that the target is also a pass-through entity for US tax purposes to avoid or minimise the effect of 'double taxation' that results from investing directly into entities that are treated as corporations for US tax purposes. However, such 'flow-through' structures could create US tax issues for tax-exempt and non-US limited partners of private equity funds that require special fund structures to address. More typically, private equity transactions involve investments in target entities that are treated as corporations for US tax purposes (such an entity sometimes referred to as a 'C corporation'). Generally, the substantial amount of debt involved in LBO transactions affords a target company significant interest expense deductions that could be available to offset taxable income. However, as a result of the Tax Reform Bill (as defined below), for tax years beginning on or after 1 January 2018, with respect to entities that are treated as C corporations, deductions for interest paid or accrued on indebtedness properly allocable to a trade or business (with certain specified exceptions)(business interest) in excess of the sum of business interest income and 30 per cent of the adjusted taxable income of the business are generally disallowed. Adjustable taxable income is computed without regard to business interest income or expense, net operating losses or deductions for pass-through income (and for taxable years before 2022, excludes depreciation and amortisation). In addition, careful attention must be paid to the terms of the acquisition debt to ensure that the interest is deductible under any other applicable US tax rules.

Private equity sponsors must also be aware of tax issues relating to management and employee compensation, which will be relevant to structuring management's investment and post-closing incentives. An example of one such tax issue is that compensation triggered by a change of control, including certain severance and consideration for equity holdings, may be 'excess parachute payments', which are subject to a 20 per cent excise tax (in addition to ordinary income taxes) and which may not be deducted by the target. Another example involves the tax treatment of different types of stock options. If an option is an 'incentive stock option', under typical facts, no income is realised by the recipient upon grant or exercise of the option and no deduction is available to the company at such times. Employees recognise tax at capital gains rates when the shares acquired upon option exercise are ultimately sold (if the applicable holding period requirements are met), and the company takes no deduction. If the award is a non-qualified stock option, no income is recognised by the recipient at the time of the grant and no deduction is available to the company at such time; rather, income is recognised, and the deduction is available to the company at the time of option exercise. There are a number of limitations on incentive stock options, and private equity sponsors generally prefer to maintain the tax deduction; accordingly, non-qualified stock options are more typical. A final example involves 'non-qualified deferred compensation'. If a deferred compensation plan is 'non-qualified', all compensation deferred in a particular year and in prior years may be taxable at ordinary income rates in the first year that it is not subject to substantial risk of forfeiture, unless payment is deferred to a date or event that is permitted under tax code section 409A's rules governing non-qualified deferred compensation.

In certain transactions in which the shares of a target corporation (or entity treated as a corporation for US federal income tax purposes) are purchased, a seller and buyer may elect to treat the acquisition of stock of such corporation as an asset acquisition for US federal tax purposes. Such an election can lead to a 'step-up' in the target's tax basis in its assets to fair market value, resulting in additional depreciation or amortisation deductions that provide a tax shield to offset future taxable income. A section 338(h)(10) election is one such election that is available when the target is a US subsidiary of a consolidated tax group or an 'S corporation' and can be advantageous because asset sale treatment can be achieved with only a single level of taxation. A 'qualified stock purchase' of the target's stock (generally an acquisition by a corporation of at least 80 per cent of the target's issued and outstanding stock) must be made to make this election. Certain typical structures used in LBOs (eg, rollover of management equity to a newly formed vehicle that purchases target stock) must be carefully analysed to determine whether such structures will render the 338(h)(10) election impermissible. Another such election is a section 336(e) election, which has similar considerations to a section 338(h)(10) election, but applies to a somewhat wider range of targets and transactions (eg, US corporate targets that are not part of a consolidated tax group). For a section 336(e) election to be available, the target must be a US corporation and the seller must be a US corporation or shareholder of an S corporation.

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10 Debt financing structures

What types of debt are typically used to finance going-private or private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Private equity buyouts generally involve senior bank debt, which is typically committed to by commercial lending institutions in the form of a senior secured revolving credit facility and senior secured term loans (which are typically syndicated to a broad array of financial institutions), and junior debt, which is typically provided in the form of a second lien term loan facility or rule 144A offering of high-yield bonds. Private equity transactions that include an anticipated rule 144A offering of high-yield bonds include 'bridge-financing commitments' pursuant to which a commercial lending institution agrees to provide 'bridge' loans in the event that the high yield bonds cannot be sold prior to the closing.

The vast majority of private equity transactions include a complete refinancing of third party debt for borrowed money in connection with the closing of the LBO. In connection with such transactions, a private equity sponsor must determine the manner in which and the cost at which existing indebtedness may be repaid or refinanced and evaluate the cost of the existing indebtedness compared with acquisition-related indebtedness. However, in transactions where target indebtedness is not expected to be retired at or before closing, the private equity sponsor must determine whether such indebtedness contains provisions that could restrict or prohibit the transaction, such as restrictions on changes of control, restrictions on subsidiary guarantees, restrictions on the granting of security interests in the assets of the target or its subsidiaries, restrictions on debt incurrences and guarantees and restrictions on dividends and distributions.

Generally, acquisitions of a US target company are not subject to any statutory financial assistance restrictions or restrictions on granting security interests in the target company's assets, except as described below or in the case of target companies in certain regulated industries. If a 'shell' company issues unsecured debt securities in a non-public offering with the purpose of acquiring the stock of a target corporation, such debt securities may be presumed to be indirectly secured by 'margin stock' (namely, any stock listed on a national securities exchange, any over-the-counter security approved by the SEC for trading in the national market system or any security appearing on the US Federal Reserve Board's list of over-the-counter margin stock and most mutual funds). If so, such debt would be subject to the US Federal Reserve Board's margin requirements and thus could not exceed 50 per cent of the value of the margin stock acquired. Private equity sponsors may avoid these requirements by utilising publicly offered debt or having the debt guaranteed by an operating company with substantial non-margin assets or cash flow.

11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements? What other documents typically set out the financing arrangements?

Purchase agreements for going-private transactions typically include representations and warranties by the private equity sponsor regarding the equity-financing commitment of the private equity sponsor and, in the case of LBOs, the third-party debt-financing commitments obtained by the private equity sponsor at the time of entering into the purchase agreement. An equity commitment letter from the private equity sponsor as well as the debt-financing commitment letters obtained by the private equity sponsor from third-party lenders are customarily provided to the target company for its review prior to the execution of the purchase agreement. In US transactions, definitive debt-financing documentation is rarely agreed at signing; instead, the definitive debt-financing documentation is typically negotiated between signing and closing on the basis of the debt-financing commitment letters delivered by third-party debt-financing sources at signing. Purchase agreements in LBOs also contain covenants relating to obligations of the private equity sponsor to use a certain level of effort (often reasonable best efforts) to negotiate definitive debt-financing agreements and obtain financing, flexibility of the private equity sponsor to finance the purchase price from other sources and obligations of the target company to assist and cooperate in connection with the financing (eg, assist with the marketing efforts, participate in road shows, provide financial statements and assist in the preparation of offering documents).

Purchase agreements typically do not condition the closing of a transaction on the receipt of financing proceeds by the private equity sponsor. If the closing is not conditioned on the receipt of financing proceeds, the purchase agreement would typically provide for a 'marketing period', during which the private equity sponsor will seek to raise the portion of its financing consisting of high-yield bonds or syndicated bank debt financing, and which begins after the private equity sponsor has received certain financial information about the target company necessary for it to market such high-yield bonds or syndicate such bank debt. Alternatively, the purchase agreement may provide for an 'inside date' before which the parties cannot be forced to close, which similarly allows for a period to finalise any debt-financing arrangements and call capital for the equity financing. If the private equity sponsor has not finalised its financing arrangements by the end of the marketing period or the inside date (and all other relevant conditions to closing have been satisfied or waived) and fails to close the transaction when required, the private equity sponsor may be required to pay a reverse termination fee – which often functions as a cap on the maximum amount of damages the target company (on behalf of itself or its shareholders) is permitted to seek from the private equity sponsor for its failure to close the transaction.

In recent years, private equity funds have increasingly utilised full equity backstop commitments. A full equity backstop commitment provides the target company assurance that the private equity sponsor is willing to fully fund the purchase price using sponsor equity if debt financing is unable to be obtained from third-party lenders by the transaction's closing date, which can increase the attractiveness of a private equity sponsor's purchase proposal relative to other bidders seeking debt financing from third-party lenders. A full equity backstop may also provide an opportunity for a private equity sponsor to obtain more favourable terms from third-party lenders, because of the credible alternative the private equity sponsor has to proceed with the transaction if debt financing is not obtained on satisfactory terms and in a timely manner from the third-party lenders prior to the signing date.

12 Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Generally, under applicable US state laws, a company may not transfer assets for less than fair consideration in the event that the company is insolvent or such asset transfer would make it insolvent. Thus, in highly leveraged transactions, there is some concern that when a target company issues or transfers its assets or equity to a private equity sponsor in exchange for the proceeds of acquisition financing, which is secured by the assets or equity of such target company, the lender's security interests in such assets or equity securities may be invalidated on a theory of fraudulent conveyance (namely the target company has transferred its assets for inadequate value). It is common for a certificate as to the ongoing solvency of the continuing or surviving company to be obtained from the target company's chief financial officer prior to closing a leveraged transaction. Purchase agreements in leveraged transactions may also include representations and warranties made by the private equity buyer as to the solvency of the company after giving effect to the proposed transaction.

Fraudulent conveyance issues should also be carefully considered by sellers in highly leveraged transactions. A board of directors considering a sale of the company should review the financial projections provided by management to a prospective buyer and the indebtedness that the prospective buyer proposes the company incur in connection with the transaction to evaluate any fraudulent conveyance risks. Directors of a target company must be particularly cautious in highly leveraged transactions in which the company has existing debt that will remain in place following the closing of the transaction. In Delaware (the leading US corporate jurisdiction), creditors of an insolvent corporation

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have standing to bring derivative actions on behalf of the corporation directly against its directors because, when a corporation is insolvent, creditors are the ultimate beneficiaries of the corporation's growth and increased value.

13 Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms? Are there any statutory or other legal protections for minority shareholders?

Depending on the size of the private equity sponsors' respective ownership stakes, shareholders' agreements entered into in connection with minority investments or 'consortium' deals may include the right of the minority investors to designate a certain number of directors and the right to approve (or veto) certain transactions (eg, change in control transactions, affiliate transactions, certain equity or debt issuances and dividends or distributions). Private equity sponsors may also seek pre-emptive rights to allow them to maintain the same percentage equity ownership after giving effect to a primary equity issuance by the target. In addition, shareholders' agreements frequently include transfer restrictions (which prohibit transfers of target securities for a particular time period and in excess of specified percentages, or both), tag-along rights (namely, the right of a shareholder to transfer securities to a person who is purchasing securities from another holder) and drag-along rights (namely, the right of a shareholder, typically the largest shareholder or a significant group of shareholders, to require other holders to transfer securities to a person who is purchasing securities from such shareholder). Private equity sponsors typically seek other contractual rights with respect to receipt of financial and other information regarding the target company, access to the properties, books and records, and management of the target company, and also rights relating to their potential exit from the investment, such as demand and piggyback registration rights (which may include the right to force an IPO), and, in some cases, put rights or mandatory redemption provisions. In certain circumstances, shareholders' agreements in private equity transactions may also contain 'corporate opportunity' covenants that either restrict (or, in some cases, expressly permit) the ability of shareholders (including private equity sponsors) to compete with the target company or make investments in other companies, which may otherwise be a potential investment or acquisition opportunity for the target company. Target companies or large shareholders that are party to shareholders' agreements may also ask for a right of first offer or right of first refusal, which would require any shareholder seeking to transfer its shares to offer to sell such shares to the company or other shareholders.

To the extent that a minority investment is made, the new shareholder should be careful to consider potential misalignment issues between the parties that may arise from its and the existing shareholders' differing investment prices, particularly as such issues may arise in terms of liquidity rights. In these types of transactions, the new shareholder often will seek one or more of:

- the right to control the timing of the liquidity event (whether it be a change of control transaction or an IPO) or the right to block such a liquidity event unless it will achieve a required minimum return on its investment;
- the right to cause a sale of the company or an IPO after some specified number of years; and
- in the event the company effects an IPO, the right to sell more than its pro rata portion of any equity securities in any registered offering of registrable securities relative to the number of equity securities sold (or to be sold) by the existing shareholder.

In the US, minority shareholders often have limited protections outside of what may be contractually negotiated in a shareholders' agreement. Generally, under applicable US state laws, the board of directors of corporations are subject to certain fiduciary duties in respect of the minority shareholders (eg, heightened scrutiny in controlling shareholder transactions with the target company, etc), and certain minimum voting requirements may apply for significant corporate actions, such as a merger. However, in most states, provisions in a target company's organisational documents may supersede the underlying statutory approval requirements. In addition, many private equity investments are held through non-corporate structures, which can be subject to more restricted fiduciary duties and other minority equityholder protections in the applicable limited liability company agreement, partnership agreement or other similar governing arrangements than would otherwise apply under applicable law. For private equity transactions structured as tender offers, US securities laws provide certain protections for minority shareholders (eg, the soliciting person is required to offer the same price to all holders of the applicable security and the tender offer must be open for 20 business days).

14 Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Under applicable US state and federal law, there are no statutory requirements to make a mandatory takeover offer or maintain minimum capitalisation in connection with shareholders acquiring controlling stakes in public or private companies. However, under applicable US state law, the board of directors of public and private companies have fiduciary duties to their shareholders that they must be mindful of when selling a controlling stake in the company. In Delaware, for example, and in many other US states, a board of directors has a duty to obtain the highest value reasonably available for shareholders given the applicable circumstances in connection with a sale of control of the company. In certain states, the applicable law permits a board of directors to also consider 'other constituencies,' such as the company's employees and surrounding community, and not focus solely on the impact that a sale of a controlling interest in the company will have on its shareholders. Private equity sponsors must be mindful of these duties of target company boards of directors as they seek to negotiate and enter into an acquisition of a controlling stake of a target company, as they may result in the target company's board of directors conducting a market check by implementing a pre-signing 'auction' or post-signing 'go-shop' process to seek out a higher bid for a controlling stake (or even the entire company) in order for the board to feel comfortable that it has satisfied its fiduciary duties to the target company's shareholders. In addition, as discussed in question 17, US target companies in certain regulated industries may be subject to certain minimum capitalisation requirements or other restrictions that may impede a private equity sponsor's ability to acquire the company.

15 Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity buyer?

A private equity sponsor will generally seek to retain flexibility on its ability to sell its stake in an acquired company, which may include having the right to require an IPO and the right to drag along other investors in the event of a sale by the private equity sponsor of all or a significant portion of its investment in the company. The ability to achieve a tax-efficient exit and the ability to receive dividends and distributions in a tax-efficient manner will also be critical factors in determining the initial structuring of a transaction, including the use of acquisition financing or other special-purpose vehicles. Private equity sponsors must also consider the interests of company management in connection with any exit and must agree with management on any lock-up or continued transfer restrictions with respect to the equity of the target company held by management as well as ongoing management incentive programmes that will continue following an IPO. In an exit (or partial exit) consummated pursuant to a portfolio company IPO, private equity sponsors typically remain significant shareholders in the company for some period of time following the IPO and, thus, continue to be subject to fiduciary duty considerations as well as securities laws, timing and market limitations with respect to post-IPO share sales and various requirements imposed by US stock exchanges with respect to certain types of related party transactions.

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When private equity sponsors sell portfolio companies (including to other private equity sponsors), buyers may seek fairly extensive representations, warranties and covenants relating to the portfolio company and the private equity sponsor's ownership. Private equity sponsors often resist providing post-closing indemnification for breaches of such provisions. In limited situations in which a private equity firm agrees to indemnification following the closing of a portfolio company sale, sponsors often use a time and amount limited escrow arrangement as the sole recourse that the buyer may have against the private equity sponsor. Sponsor sellers and buyers have also addressed disagreements over indemnity through the purchase of transaction insurance (eg, representations and warranties insurance) to provide post-closing recourse to the buyer for breaches of representations or warranties. In such a case, the cost of purchasing the transaction insurance is typically negotiated by the buyer and seller as part of the purchase price negotiations.

16 Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

Private equity sponsors take a variety of approaches in connection with the rights they retain following a portfolio company IPO, depending on the stake retained by the private equity sponsor following the IPO. In many cases, the underwriters in the applicable IPO will seek to significantly limit the rights that a private equity sponsor will be permitted to retain following the IPO as it may diminish the marketability of the offering. For example, tag-along rights, drag-along rights, pre-emptive rights, and rights of first offer or rights of first refusal, in each case, for the benefit of the private equity sponsor frequently do not survive following an IPO. Except as described below, US regulations and US stock exchange rules do not generally legislate which governance rights may survive an IPO. In addition, private equity sponsors should consider the impact of shareholder advisory firms, such as Institutional Shareholder Services (ISS), that provide guidance to shareholders with respect to public company governance practices. For example, ISS has announced that for newly public companies it will recommend that shareholders 'vote against' or 'withhold' their votes for directors that, prior to or in connection with an IPO, adopted by-law or charter provisions that ISS considers adverse to shareholders' rights, including classified boards, supermajority voting thresholds and other limitations on shareholders' rights to amend the charter or by-laws and dual-class voting share structures.

Private equity sponsors will often retain significant board of director nomination rights, registration rights and information rights following an IPO, and may, in certain limited circumstances, retain various veto rights over significant corporate actions depending on the board control and stake held by the private equity sponsor. Under applicable US stock exchange rules, boards of directors of public companies are typically required to be comprised of a majority of 'independent' directors, but certain exceptions exist if a person or group would retain ownership of more than a majority of the voting power for the election of directors of the company, in which case the company is referred to as a 'controlled company,' or if the company is organised outside of the US. However, in order to improve the marketability of the offering and employ what are perceived to be favourable corporate governance practices, many private equity sponsors forgo the benefits of controlled-company status or those applicable to foreign private issuers and employ a majority of independent directors and only retain minority representation on the board of directors following the IPO.

In addition, private equity sponsors typically retain the right to cause the company to register and market sales of securities that are held by the private equity sponsor and to permit the private equity sponsor to participate in piggyback registrations following an agreed-upon lock-up period (which typically expires 180 days after the date of the IPO), subject to any applicable black-out rules and policies of the company and US securities laws. Private equity sponsors often seek to control the size and timing of their exits, including sales of their equity securities following an IPO within the confines and restrictions of the public company environment. As a result, many private equity sponsors often seek to sell large blocks of their securities in an 'overnight' underwritten shelf takedown off of a pre-existing shelf registration statement. Given the timing limitations on such shelf takedowns, it is not uncommon for such registered offerings to be exempt from, or have very truncated notice provisions relating to, piggyback registration rights of other holders of registrable securities.

17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Private equity sponsors select companies as attractive acquisition candidates based on a variety of factors, including steady cash flow, strong asset base to serve as loan collateral or as the subject of future dispositions, strong management team, potential for expense reduction and operational optimisation, undervalued equity and limited ongoing working capital requirements. Private equity sponsors look toward targets across a wide spectrum of industries, including energy, financial, food, healthcare, media, real estate, retail, software, technology and telecoms. In recent years, private equity sponsors have become increasingly interested in the technology sector, which has historically been considered to be the predominant domain of venture capital firms. In addition, certain private equity funds have a specified investment focus with respect to certain industries (eg, energy, retail and real estate) or types of investments (eg, distressed debt).

Many regulated industries (eg, banking, energy, financial, gaming, insurance, media, telecoms, transport, utilities) must comply with special business combination laws and regulations particular to those industries. Typically, approval of the relevant federal or state governing-agency is required before transactions in these industries may be completed. In certain situations, regulators may be especially concerned about the capitalisation and creditworthiness of the resulting business and the long and short-term objectives of private equity owners. In addition, as a result of the extensive information requirements of many US regulatory bodies, significant personal and business financial information is often required to be submitted by the private equity sponsor and its executives. Furthermore, in certain industries in which non-US investments are restricted (eg, media, transport), private equity sponsors may need to conduct an analysis of the non-US investors in their funds to determine whether specific look-through or other rules may result in the sponsor investment being deemed to be an investment by a non-US person. While none of these factors necessarily preclude private equity sponsors from entering into transactions with regulated entities, all of these factors increase the complexity of the transaction and need to be taken into account by any private equity sponsor considering making an investment in a regulated entity.

18 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

The structure of a cross-border private equity transaction is frequently quite complicated, particularly given the use of leverage in most transactions, the typical pass-through tax status of a private equity fund and the existence of US tax-exempt and non-US investors in a private equity fund. Many non-US jurisdictions have minimum capitalisation requirements and financial assistance restrictions (which restrict the ability of a target company and its subsidiaries to 'upstream' security interests in their assets to acquisition financing providers), each of which limits a private equity sponsor's ability to use debt or special purpose vehicles in structuring a transaction. As noted in question 17, non-US investors may be restricted from making investments in certain regulated industries, and similarly, many non-US jurisdictions prohibit or restrict the level of investment by US or other foreign persons in specified industries or may require regulatory approvals in connection with acquisitions, dispositions or other changes to investments by foreign persons. In addition, if a private equity sponsor seeks to make an investment in a non-US company, local law or stock exchange restrictions may impede the private equity sponsor's ability to obtain voting, board representation or dividend rights in connection with

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Update and trends

Tax reform

On 22 December 2017, President Trump signed major tax reform legislation passed by the House and Senate under the Tax Cuts and Jobs Act (the Tax Reform Bill), which is generally effective as of 1 January 2018. Among the numerous changes included in the Tax Reform Bill are:

- a permanent reduction in the corporate income tax rate;
- a partial limitation on the deductibility of interest paid or accrued on indebtedness properly allocable to a trade or business (subject to certain exceptions);
- a new deduction for individuals receiving certain business income from 'pass-through' entities; and
- a partial shift of the US taxation of multinational corporations from a tax on worldwide income to a territorial system (along with a transitional rule that taxes certain historical accumulated earnings and rules that prevent tax-planning strategies that shift profits to low-tax jurisdictions).

The impact of the new and sweeping tax law changes on private equity transactions is uncertain.

Committee on Foreign Investment in the United States (CFIUS)

In 2017, we have seen sponsors and other dealmakers assessing cross-border transactions pay increased attention to CFIUS risk and measures designed to mitigate CFIUS risk. Given the new administration's avowed trade policies and increased protectionism, as well as diplomatic tensions involving North Korea, many practitioners have seen increasing and unprecedented scrutiny of inbound investments, particularly from Chinese buyers, and expect this trend to continue. For example, in September 2017, the President issued an executive order blocking the proposed US$1.3 billion sale of Lattice Semiconductor Corp to affiliates of Canyon Bridge Capital Partners, a private equity firm managed by US nationals whose investors include several Chinese state-owned enterprises. Consequently, in recent cross-border transactions, and in particular in transactions involving sales of portfolio companies that are in sensitive industries or possess sensitive data or technology and that implicate national security concerns, we have seen some sponsors consider or utilise creative mechanisms for allocating CFIUS risk, including negotiating pre-emptive divestitures of certain assets and specific termination fees tied to CFIUS approval. In addition, we have seen some foreign buyers structure deals as minority or passive investments, rather than acquisitions of control, which may, in certain cases, have been done in an effort to avoid or mitigate CFIUS risk.

its investment or effectively exercise pre-emptive rights, implement capital raises or obtain additional financing.

US sponsors seeking to sell portfolio companies to non-US buyers or considering other transactions involving sales to foreign acquirers should be aware of the possibility of review by the Committee on Foreign Investment in the United States (CFIUS). CFIUS is a multi-agency committee authorised to review transactions that could result in foreign control over US businesses for potential impacts on US national security. CFIUS has authority to negotiate and implement agreements to mitigate any national security risks raised by such transactions. In the absence of a mitigation agreement, CFIUS can recommend that the President suspend, prohibit or unwind a transaction. A CFIUS review can add delays and meaningful uncertainty to transactions depending on the nature of the target business and the identity of the foreign acquirer. In transactions involving the sale of a portfolio company that is in a sensitive industry or that handles sensitive data, especially to buyers that CFIUS considers are from countries of concern, sponsors will be prudent to consider whether a CFIUS filing is advisable, to propose reverse termination fees or pre-emptive divestitures, to discuss possible mitigation efforts the buyer is willing to make and to build political support for the transaction. While the regulatory and other challenges in cross-border sponsor exits and other transactions, including CFIUS review, are often manageable in many contexts, they increase the level of resources required and may otherwise complicate the process for executing such transactions.

Furthermore, in a cross-border transaction, the private equity sponsor must determine the impact of local taxes, withholding taxes on dividends, distributions and interest payments and restrictions on its ability to repatriate earnings. Private equity sponsors must also analyse whether a particular target company or investment vehicle may be deemed to be a controlled foreign corporation or passive foreign investment company, both of which can give rise to adverse US tax consequences for investors in the private equity fund. Any of these issues may result in tax inefficiencies for investors or the violation of various covenants in a private equity fund's underlying documents that are for the benefit of its US tax-exempt or non-US investors.

19 Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

Private equity sponsors may form a consortium or 'club' to jointly pursue an acquisition or investment for a variety of reasons, including risk-sharing and the ability to pursue a larger acquisition or investment, since most fund partnership agreements limit the amount a fund may invest in a single portfolio company. In addition, private equity sponsors may form a consortium that includes one or more strategic partners who can provide operational or industry expertise, financial resources or both on an ongoing basis. Partnerships with a strategic buyer can be mutually beneficially insofar as the strategic partner may provide the private equity sponsor with a potential liquidity option upon exit if it is willing to purchase the sponsor's stake in the future. Moreover, the strategic partner can mitigate the risk of the investment by negotiating the flexibility to either buy out the private equity sponsor if projected synergies are realised with the target company, or, if synergies are not realised, exit its investment along with the private equity sponsor.

An initial consideration to be addressed in a club deal is the need for each participant's confidentiality agreement with the target company to allow such participant to share confidential information regarding the target company with the other members of the consortium. Such confidentiality agreements may permit the participant to share information with co-investors generally or with specifically identified co-investors or may restrict the participant from approaching any potential co-investors (at least during an initial stage of a sale process) without obtaining the target company's prior consent. Private equity sponsors may also consider including provisions in such confidentiality agreements permitting or restricting the members of the consortium from pursuing a transaction with the target on their own or with other co-investors or partners in the event that the consortium falls apart. Potential buyers' compliance with confidentiality agreements, including provisions limiting the ability of the potential buyer to share information with co-investors, has received significant attention in the US, with various litigations having been commenced with respect to these issues.

Counsel to a consortium must ensure that all of the members of the consortium agree upon the proposed price and other material terms of the acquisition before any documentation is submitted to, or agreed with, the target company. In addition, counsel to a consortium must ensure that the terms of any proposed financing, the obligations of each consortium member in connection with obtaining the financing and the conditions to each consortium member's obligation to fund its equity commitment have been approved by each member of the consortium. It is not uncommon for consortium members to enter into an 'interim investors agreement' at the time of signing a definitive purchase agreement or submitting a binding bid letter that governs how the consortium will handle decisions and issues related to the transaction that may arise following signing and prior to closing. An interim investors agreement may also set forth the key terms of a shareholders' agreement to be entered into by the consortium members related to post-closing governance and other matters with respect to the acquisition. Members of a consortium that involves a potential strategic partner should be mindful of potential increased regulatory and antitrust risk if a target company has operations that compete with or address the same market as the operations of the strategic partner.

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Each member of the consortium may have different investment horizons (particularly if a consortium includes one or more private equity sponsors and a strategic partner), targeted rates of return, tax or US Employee Retirement Income Security Act issues and structuring needs that must be addressed in a shareholders' agreement or other ancillary documentation relating to governance of the target company and the future exit of each consortium member from the investment. Particularly where a private equity sponsor is partnering with a strategic buyer, the private equity sponsor may seek to obtain certain commitments from the strategic buyer (eg, non-competition covenants and no dispositions prior to an exit by the sponsor), the strategic buyer may seek to limit the veto rights or liquidity rights (or both) of the private equity sponsor. As discussed in question 13, a shareholders' agreement would typically provide the consortium members with rights to designate directors, approval rights and veto rights and may include provisions relating to pre-emptive rights, tag-along and drag-along rights, transfer restrictions, future capital contributions, put rights, mandatory redemption provisions, rights of first offer or first refusal, and restrictive covenants that limit the ability of each consortium member to engage in certain types of transactions outside of the target company. The various rights included in a shareholders' agreement are frequently allocated among consortium members on the basis of each member's percentage ownership of the target company following the consummation of the acquisition.

20 Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity buyer related to certainty of closing? How are these issues typically resolved?

Target companies and their boards of directors generally seek to obtain as much certainty with respect to closing a transaction as possible, which includes limited conditions to the buyer's obligation to close the transaction and the ability to specifically enforce the obligation to close a transaction against the buyer. In private equity transactions without a financing condition, many private equity sponsors have made efforts to ensure that the conditions to their obligation to consummate the acquisition pursuant to the purchase agreement are substantially the same as the conditions of the lenders to fund the debt financing to the private equity sponsor's shell acquisition vehicle or are otherwise fully within the private equity sponsor's control.

Private equity sponsors have historically resisted a specific performance remedy of the sellers in acquisition agreements. Private equity sponsors often use third-party debt financing in acquisitions and generally do not want to be placed in a position where they can be obligated to close a transaction when the third-party debt financing is unavailable and the ability to obtain alternative financing is uncertain. In addition to the fact that the transaction may no longer be consistent with the private equity sponsor's financial modelling in the absence of such debt financing (namely, the transaction would be unlikely to generate the private equity sponsor's target internal rate of return), private equity sponsors are limited in the size of the investments they are permitted to make pursuant to their fund partnership agreements and therefore may not be able to purchase the entire business with an all-equity investment. As a result, private equity sponsors commonly require the ability to terminate the purchase agreement and pay a specified reverse termination fee to the target company in the event that all of the conditions to the closing have been satisfied (or are capable of being satisfied on the applicable closing date) but the sponsor is unable to obtain the debt financing necessary to consummate the closing, as described in question 11.

Current market practice provides that some private equity sponsors agree to a limited specific performance remedy in which, solely under specified circumstances, target companies have the right to cause the shell acquisition vehicle to obtain the equity proceeds from the private equity fund and consummate the transaction. In the instances in which such a limited specific performance right has been agreed, such right will arise solely in circumstances where:

- the closing has not occurred by the time it is so required by the purchase agreement (which is typically upon the expiry of the marketing period for the buyer's third-party debt financing);
- all of the conditions to closing have been satisfied (or will be satisfied at the closing);
- the debt financing has been funded (or will be funded if the equity financing from the private equity sponsor will be funded); and
- in some cases, the seller irrevocably confirms that, if specific performance is granted and the equity and debt financing is funded, then the closing will occur.

In recent years, some private equity sponsors have been willing to provide an equity commitment at signing that backstops the entire purchase price for a transaction, allowing the target company to cause the sponsor to consummate the transaction even if the third-party debt financing is not available at the time of closing. Whether a private equity sponsor is willing to provide a full equity backstop depends largely on the size of the sponsor's fund relative to the size of the target company and the ability under the fund's partnership agreement to draw sufficient capital for a single transaction, as well as the competitiveness of the sale process. A full equity backstop can meaningfully increase the attractiveness of a sponsor's proposal by removing financing risk.

In addition, it is not uncommon for private equity sponsors to agree to give the seller the right to specifically enforce specified covenants in the purchase agreement against the private equity sponsor's shell acquisition vehicle (eg, using specified efforts to obtain the debt financing, complying with the confidentiality provisions and paying buyer expenses).

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