PRIVATE EQUITY 2022

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LEXOLOGY
Getting the Deal Through

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Lexology Getting the Deal Through is delighted to publish the eighteenth edition of *Private Equity*, which is available in print and online at www.lexology.com/gtdt.

Lexology 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 Lexology 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 India and Turkey.

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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.

Lexology 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, Atif Azher of Simpson Thacher & Bartlett LLP, for his continued assistance with this volume.

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Simpson Thacher & Bartlett LLP

Global overview

Global mergers and acquisitions (M&A) deal volume and value measured in dollars reached historic levels during 2021, continuing the strong rebound that began during the second half of 2020 after the worldwide reduction in global M&A activity that resulted from market uncertainty caused by the onset of the covid-19 pandemic. M&A deal value reached US$5.9 trillion during 2021, a year-over-year increase of 64 per cent and the highest annual global M&A value ever recorded. An announced US$1.5 trillion of M&A activity during the fourth quarter of 2021, the second-largest quarter for M&A activity on record, marked the sixth consecutive quarter to surpass US$1 trillion. As part of this increase in global M&A activity, over 63,000 deals were announced during 2021, an increase of 24 per cent compared to 2020 levels and an all-time high (all the above data from Refinitiv). Global M&A volume has remained strong overall in the context of the past decade, exceeding the US$3 trillion barrier for the eighth consecutive year. Global private equity buyout activity reached US$2.1 trillion over 8,545 deals, nearly doubling the previous record set for deal value in 2007 (US$1.1 trillion) (Mergermarket). Global cross-border M&A deal activity surpassed US$2 trillion for the first time, with a 68 per cent increase to an estimated US$2.1 trillion in 2021, as compared with US$1.3 trillion in 2020. The global median earnings before interest, taxes, depreciation, and amortisation multiple hovered around 11.4x in 2021, just under the 12.1x reached during 2020 (Pitchbook). The number of deals with a value greater than US$10 billion increased to a record 55 in 2021, an increase of 30 per cent from 2020 and the highest number of mega-deals since 2019. The value of private equity-backed buyout deals accounted for 20 per cent of all M&A activity during 2021, a significant increase from US$608.7 billion and just over 16 per cent of all M&A activity during 2020. On the sell side, private equity exits to buyers rose in value to US$592.8 billion in 2021, a 53 per cent increase from 2020, and surpassed the previous full-year high of US$430.3 billion reached during 2018. In addition, annual secondary volume set a full-year record of US$132 billion in 2021 (Jefferies). Globally, capital raised by private equity funds reached approximately US$1.2 trillion, more than doubling from 2020, as more than 14,500 private equity deals were announced (an increase of 56 per cent as compared to 2020). Special purpose acquisition companies (SPACs) announced US$598.8 billion raised across 355 initial business combinations during full-year 2021, accounting for 10 per cent of all M&A volume.

Americas

Announced M&A deal value in 2021 in the Americas totalled approximately US$2.9 trillion across 21,272 deals (Refinitiv). The economic resurgence in the United States and Canada drove these historic numbers, as both countries' economies recovered to – and exceeded – their pre-pandemic gross domestic product levels during early 2021. Levels of private-equity backed M&A activity in the United States, which began to rise during the second half of 2020, continued to reach historic levels in 2021 with regard to overall deal value, especially during the second half of the year. Private equity deal activity reached the highest level relative to trends over the past 20 years, driven by strong buyout activity in the technology and business products and services sectors, as well as a healthy market for private equity investments in late-stage companies exhibiting high growth, in an effort to fund plans for continued expansion, also known as growth equity. Growth equity accounted for 12.4 per cent of deal value in 2021, the highest percentage since 2009 (all the above data from Pitchbook). M&A deal volume for targets in the Americas, excluding the United States, increased from 2020 levels, with 4,979 deals announced in 2021 as compared to 4,233 deals in 2020. Total deal value for targets located in the Americas, excluding the United States, was approximately US$330 billion in 2021, up approximately 89 per cent from US$175 billion in 2020 (Refinitiv). Latin American countries witnessed increased levels of activity in the global M&A market throughout the majority of 2021, although the number of financial M&A deals completed in Latin America fell 33 per cent year-over-year during the fourth quarter of 2021, suggesting that M&A activity levels in Latin America may decrease during 2022. The number of financial M&A transactions totalled only 26 in Latin America during the fourth quarter of 2021, down from 39 in the last quarter of 2020 and down from 29 in the third quarter of 2021 (S&P Global). US private equity activity remained strong overall in 2021 with respect to both deal volume and value. The year ended with approximately US$572 billion in deal value across 6,488 private equity transactions (Refinitiv). However, despite the cumulative success of US private equity in 2021, each successive quarter for the year saw M&A deal volume and value decrease in the United States, suggesting a potential downward trend going into 2022 (PwC). Notable announced or completed private equity acquisitions in the Americas in 2021 included the US$34 billion acquisition of Medline Industries by the Blackstone, Carlyle Group, GIC and Hellman & Friedman; the US$17 billion acquisition of AthenaHealth by Bain Capital and Hellman & Friedman; the US$7.2 billion acquisition of Athene Holding by Apollo Global Management; and in Brazil, the US$400 million acquisition of EBANX SA by Advent International Corp.

Europe, the Middle East and Africa

Announced M&A deal value for targets located in Europe, the Middle East and Africa totalled approximately US$1.74 trillion in 2021, an increase of approximately 54 per cent from US$1.13 trillion in 2020. Europe accounted for approximately US$1.54 trillion of the total announced M&A deal volume, up approximately 46 per cent from US$1.05 trillion in 2020. M&A deal value involving the Middle East and Africa reached approximately US$200.1 billion across 2464 deals, representing its highest value on record, more than twice the deal value reported in 2020 (all the above data from Refinitiv). European-based private equity activity (including exits, buyouts and secondary buyouts) reached €754.5 billion across 7,197 deals, exceeding the 2019 record of 4,566 deals and the 2018 record of €498.2 billion in deal value. The median deal value increased 60 per cent from the previous year, as the middle market (deals between €100 to 500 million) increased over 60 per cent year-over-year to a new annual high. Meanwhile, European private equity deals under €25.0 million contributed to the majority of deal volume, spiking over 20 per cent as compared to last year to record highs. Based on recent activity, certain regions in Europe, including the United Kingdom, Ireland and Germany, are expected to see continued increases in M&A activity levels during 2022. The new three-party coalition government in Germany is expected to create new potential opportunities for the M&A market, with its focus on digitising the German economy and the prioritisation of green technology. The United Kingdom and Ireland continue to attract buyers due to modestly valued companies and political stability, primarily the result of an avoidance of a no-deal Brexit (all the above from Pitchbook). The European initial public offering (IPO) market recovered from its slowdown during 2020, the result of the onset of the covid-19 pandemic, with a total of 142 companies going public and raising US$104.7 billion in 2021, year-over-year increases of 149 per cent and 780 per cent, respectively. Between 2017 and 2021, the average pre-IPO valuation in Europe has risen from US$141.6 million to US$874.1 million (Pitchbook). Notable announced or completed European private equity transactions in 2021 included Blackstone, CDP and Macquarie's €9.8 billion joint-acquisition of a controlling share in Autostrade per I'talia; Warburg Pincus and Apax Partners' joint acquisition of T-Mobile Netherlands for US$6.05 billion; Hellman & Friedman and EQT's US$4.3 billion takeover of Zooplus AG; and EQT's US$4.6 billion acquisition of First Transit and First Student.

Asia-Pacific

Announced M&A deal value in the Asia-Pacific region totalled approximately US$1.32 trillion across 21,721 deals in 2021, which represented an increase in deal value of approximately 30 per cent as compared to the approximately US$1.02 trillion in deal value reached in 2020. The region accounted for approximately 22 per cent of global deal value, which although a slight decrease from the region's share in 2020, represents a substantial increase from the seven per cent that it had in 2019. Announced M&A deal value involving China reached US$586.6 billion in 2021, a 3.9 per cent increase over 2020 deal value. Deal volume increased 17.1 per cent year-over-year, achieving a record-high that exceeded 8,000. During the fourth quarter of 2021, overall M&A deal value involving China reached US$162.7 billion, an increase of 15.8 per cent as compared to the third quarter of 2021. Chinese outbound acquisitions were up 19 per cent as compared to 2020, totalling US$43.0 billion, while activity involving foreign firms acquiring Chinese companies was up 23.8 per cent from 2020, totalling US$55.7 billion. However, the number of deals announced in the fourth quarter dropped 26 per cent compared with the third quarter of 2021. In Japan, there were 1,216 private equity-backed deals in 2021, with a deal value of over US$16 billion. Both deal volume and deal value for Japanese private equity increased from 2020 to 2021, however, as a share of the Asia-Pacific region, Japanese private equity fell from 9.3 per cent of the regional value in 2020 to 3.6 per cent in 2021 (all the above data from Refinitiv). A notable private equity transaction announced in the Asia-Pacific region in 2021 was the acquisition of Tokopedia PT by Aplikasi Karya Anak Bangsa PT for approximately US$7.5 billion.

Debt-financing markets

In 2021, global syndicated loan revenue and volume increased 49 per cent to US$5.4 trillion and 18 per cent to over 10,000 loans, respectively, from 2020 levels. This increase resulted in the highest revenue recorded since 1980 and a three-year high for volume. Fourth-quarter 2021 loan proceeds totalled US$1.3 trillion, a 3 per cent increase from the third quarter, potentially foreshadowing sustained high levels in 2022. Globally, acquisition-related financing increased to US$928.0 billion during 2021, a 70 per cent increase from a year ago and the strongest period for acquisition-related lending since 2018. European borrowing reached a six-year high, totalling $960.6 billion across 1,354 deals for 2021, a 13 per cent increase in proceeds. Asia-Pacific lending increased 19 per cent year-over-year, totalling $570.7 billion, despite a 14 per cent decrease in Japanese lending. This growth was led by China- and Hong-Kong based loans, which accounted for 48 per cent of total Asia-Pacific proceeds during 2021. The volume of bond issuances by investment-grade-rated US companies reached $1.08 trillion in 2021, down 28 per cent from 2020, but still higher than the $965 billion in 2019 (all the above data from Refinitiv). Leveraged loan issuance in 2021 reached a new high of $305 billion, outpacing the 2018 full-year record of $275 billion. High-yield bond issuance in the United States saw an increase from year-ago levels, increasing to US$445 billion, as compared to US$435 billion in 2020 (S&P Global).

Portfolio company sales and public listings

Portfolio company exits by private equity sponsors saw significant increases in value during 2021. Globally, in 2021, financial sponsors exited approximately US$958 billion of investments, more than twice the 2020 levels. Deal count increased to 2,834 in 2021, as compared with 1,583 in 2020 (Refinitiv). In 2021, there were 984 secondary buyouts, which totalled approximately US$309.4 billion in value (Mergermarket). This increase represents an increase from just US$109.2 billion in 2020. While 2021 was highly productive for private equity-backed exits, opportunities should continue to be sought going into 2022, as nearly 70 per cent of the companies acquired by sponsors in 2016 are still owned by those sponsors (Pitchbook). US private equity exit activity reached approximately US$650 billion over 1,736 exits, a 146 per cent increase in deal value and a 97 per cent increase in deal volume as compared to 2020 (Refinitiv). Venture capital-backed companies raised $329.9 billion in 2021, nearly double the previous record from 2020.

Notable announced portfolio company investment exits in 2021 included Thermo Fisher Scientific Inc's US$21 billion acquisition of PPD, Inc from Hellman & Friedman, Carlyle, GIC Private Limited and the Abu Dhabi Investment Authority; and EQT's US$9.6 billion exit from Aldevron LLC.

Year 2020 drew to a close with big-name IPO's like DoorDash and Airbnb stimulating the IPO market. This proved to be a prelude for an even more active year in 2021, as IPO activity reached levels not seen since the dot-com boom approximately two decades ago. In 2021, there were 397 completed IPOs, which raised approximately US$142 billion, an 82 per cent increase in deal volume from 218 completed IPOs in 2020 and an 81 per cent increase in deal value from US$78.2 raised in 2020 (Renaissance Capital). Private equity-backed IPOs broke previous annual records in only three quarters of 2021, with 42 private equity-backed US public listings, contributing to a fifth consecutive quarter of increased listings. These IPOs surpassed US$90 billion in value and accounted for more than 42 per cent of private equity exit value for just the first three quarters. A total of 13 private equity firms had IPOs in 2021, offering over US$4.6 billion. This lifted the trend for increased private equity IPOs where 2019 left off after the covid-19 pandemic dramatically reduced such private-equity activity to only seven offerings totalling US$646 million in 2020 (S&P Global). In 2021, the exit value of US public listings backed by private equity increased to US$288.8 billion, increasing over 29 per cent from US$222.9 billion in 2020 (Pitchbook).

After a record first-half volume of US$48 billion, the annual volume for secondary transactions set a full-year record of US$132 billion in 2021. This represented a 120 per cent increase from 2020 and beat the prior record set in 2019 by 50 per cent. Volume for general partner (GP)-led transactions in the secondary market grew 94 per cent from 2020 to a record US$68 billion, surpassing volume for traditional limited partner-led transactions for a second straight year. Continuation funds – funds raised by private equity sponsors for purposes of moving all or a portion of the ownership of certain of their assets held by existing funds to a newly created fund – compromised 84 per cent of GP-led market volume. Continuation funds permit GPs and certain investors to hold assets for longer periods, rather than seeking traditional liquidity paths such as a public listing or a secondary sale to a third party. Single-asset continuation funds in particular quickly established a popular alternative to traditional exit paths during 2021 and represented 48 per cent of total GP-led transaction volume. Whereas multi-asset continuation funds accounted for 36 per cent of total market volume in 2021 (all the above data from Jefferies). Notable private equity portfolio company public listings in 2021 include the listing of PowerSchool Holdings Inc, a portfolio company of Vista Equity Partners and Onex Corp, on the New York Stock Exchange, resulting in a valuation of US$3.5 billion; and the listing of Bright Health Group, backed by Tiger Global and Blackstone, resulting in a valuation of US$11.23 billion.

Rise in private equity fundraising

Global private equity fundraising reached an all-time high in 2021, as funds across buyouts, venture capital, growth equity, secondaries and other strategies gathered US$733 billion (all statistics in this section provided by Private Equity International). This represents an increase of approximately 27 per cent over 2020, during which US$535 billion was raised in the midst of the economic downturn and other challenges caused by the covid-19 pandemic. Moreover, the number of funds closed in 2021 rose slightly relative to 2020, marking the first increase in such numbers since 2018; 1,384 funds held a final close by the end of December 2021, compared to 1,313 funds in 2020.

Consistent with 2019 and 2020, capital was largely concentrated at mega-funds (ie, funds raising approximately US$5 billion or more) of recognised, top-performing sponsors. This concentration demonstrates 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, consolidate manager relationships and invest with sponsors with whom they had prior relationships (particularly in light of difficulties in meeting new sponsors in person during the covid-19 pandemic). Specifically, the 10 largest funds that reached a final close in 2021 together raised close to US$150 billion, which represents 20 per cent of the total capital raised during 2021. This indicates a slight decrease in consolidation from 2020, where the 10 largest funds that reached a final close in 2020 raised approximately a quarter of the total 2020 capital raised. Additionally, the average fund size for 2021 was the largest on record, at US$530 million. This represents an increase of US$63 million over 2020 and almost a 50 per cent increase over 2017.

Regarding the distribution of capital across different types of private equity funds, buyout funds accounted for a fifth by number of the 965 funds that closed from January to September of 2021, and almost 50 per cent of the capital raised during such period (a slight decline from 51 per cent in 2020). Growth funds accounted for the second-largest sector by the amount of capital raised during such period; this strategy raised US$105 billion through the third quarter of 2021, more than doubling the full-year growth fund capital total for 2020. Venture capital funds constituted 47 per cent of the total 2021 fund count and 16 per cent of the amount of capital raised through the third quarter of 2021 (an increase from 2020). Conversely, secondaries fundraising declined this year through the third quarter of 2021. US$47 billion was closed in secondaries funds over this period, compared to a full-year total of US$82 billion in 2020, and secondaries funds represented 7 per cent compared to 2020's 14 per cent of total capital raised.

Geographically, the fundraising rebound in 2021 was particularly evident in North America-focused funds. The amount of capital raised by North America-focused funds doubled year-on-year (from the third quarter of 2020 to the third quarter of 2021) to US$240.9 billion. Comparatively, the percentage of total capital raised by Europe-focused funds decreased to 8 per cent from approximately 12 per cent in 2020. Additionally, as of the third quarter of 2021, the capital raised by funds focused on multiple regions grew 32 per cent from the equivalent period last year.

It is expected that overall fundraising levels will keep pace in the near term, particularly as many fund managers return to the market quickly. A record 3,395 funds in the global market are targeting US$952 billion. Further, the top 10 funds in the global market are looking to raise almost US$180 billion, and at least 15 funds are targeting US$10 billion.

Many investors are also placing a premium on managers with established track records that have navigated a number of past economic cycles. As larger institutional investors will continue to consolidate their relationships with experienced 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, continuation funds, early-closer incentives, umbrella funds, anchor investments, core funds, growth equity funds, impact funds, GP minority stakes investing, secondaries 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 accommodate investors by either lowering fees, expanding co-investment opportunities, focusing on unique investment opportunities or exploring other alternative strategies. In addition, in light of the strong, less volatile performance by private equity funds over recent periods relative to the public markets, institutional investors may increasingly shift allocations from the public markets to private equity. Moreover, it is anticipated that private equity fundraising will continue to focus on established, dominant markets in North America and Europe. Finally, it is also expected that the US Securities and Exchange Commission will continue to focus on transparency (eg, full and fair pre-commitment disclosure and informed 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.

Outlook for 2022

After an interruption in M&A activity during early 2020 as a result of the covid-19 pandemic, global private equity activity reached historic highs in 2021. This M&A activity is expected to stay at high levels, but perhaps not at the same levels from all-time highs set in 2021. The year-end momentum may slow down as a result of elevated levels of inflation, anticipated increases in interest rates, supply-chain issues and emerging covid-19 variants. Nonetheless, M&A activity is expected to remain strong in light of historic levels of monetary and fiscal stimulus, creative industry solutions and high levels of dry powder in the market. Private equity firms continue to have record levels of dry powder, reportedly over US$2.3 trillion going into 2022, 14 per cent higher than the year-end 2020 levels (PwC). We expect private equity firms to continue to find ways to deploy capital, and we have already seen private equity firms raise new, larger flagship funds to help extend and sustain the pace of private equity-backed M&A activity throughout 2022. In addition, as of year-end, over 500 SPACs collectively hold over US$138 billion in IPO proceeds as dry powder while seeking M&A targets for de-SPAC transactions. We expect that private equity sponsors may deploy their capital to take advantage of the recent drop off in valuations led by the market selloff in January 2022. Moreover, we expect the popularity of GP-led transactions and continuation funds to remain high in 2022.

United Kingdom

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FORMATION

Forms of vehicle

1 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 England and Wales, private equity funds are typically formed as English limited partnerships (ELPs) pursuant to the Limited Partnerships Act 1907 (the 1907 Act) and are also subject to relevant provisions of the Partnership Act 1890 (the 1890 Act) and common law and equity principles (unless, subject to certain overriding principles, modified by agreement between the partners in the ELP).

An ELP comprises a general partner (GP) and one or more limited partners (LPs). The liability of LPs for the debts and obligations of an ELP is limited to the amount of capital each such LP contributed to the ELP provided that the LPs do not take part in the management of the business of the ELP. In contrast, the GP of an ELP will have unlimited liability for the debts and obligations of an ELP. The GP may act as manager of the ELP, or may, on behalf of the ELP, alternatively appoint a separate manager who is not a partner in the ELP to manage the business of the ELP. The appointment of a separate manager is common practice for private equity sponsors with multiple funds looking to ring-fence the unlimited liability of a GP in respect of each fund. Managing a private equity fund is also a regulated activity that requires authorisation. Having a separate authorised manager who can act as a manager across different funds, therefore, avoids the need to undertake multiple authorisations, which can be both costly and time-consuming. In such circumstances, the sponsor's regulated manager will be appointed to manage the ELP, with a new entity with limited assets established to act as GP in respect of each fund.

In 2017, the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (the 2017 Order) introduced a sub-class of ELPs, private fund limited partnerships (PFLPs), into English law. The primary aim of the UK government in creating this sub-class of ELPs was to improve the attractiveness of ELPs as a vehicle of choice for private funds by simplifying certain administrative requirements and clarifying certain matters that apply to a standard ELP. In particular, LPs in a PFLP benefit from a white list of actions that are expressly stated not to constitute the management of the business of the ELP and accordingly may be taken by LPs without the risk of loss of their limited liability. The PFLP has accordingly become the vehicle of choice for private equity sponsors establishing funds in England and Wales LPs.

ELPs do not have separate legal personality and accordingly cannot hold property in their own right or enter into contracts on their own behalf. Accordingly, ELPs act through their general partners or managers as agents of the ELP, who will hold the property of the ELP on trust. However, Scottish limited partnerships (which are also subject to the 1907 Act but differ from ELPs in certain respects) do have separate legal personality and accordingly are commonly used as vehicles that are partners in ELPs (eg, carried interest vehicles or feeder funds).

Forming a private equity fund vehicle

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

An ELP requires at least one GP and one LP who agree to carry out a business in common with a view to profit. A GP may be a natural person, a corporate entity or another partnership with separate legal personality. To ensure that the ELP is not a qualifying partnership for the purposes of the Companies and Partnerships (Accounts and Audit) Regulations 2013 (2013 Regulations) and accordingly is not subject to a requirement to file public accounts with Companies House, it has become common practice for sponsors utilising ELPs as fund vehicles to appoint at least one GP that is not a limited company, such as a limited liability partnership. Unless the ELP is a PFLP, an LP must contribute to the capital of the ELP on admission to the ELP to obtain limited liability status (there is no such requirement for the GP). However, this need only be a nominal amount.

Given that both the 1907 Act and the 1890 Act contain default statutory provisions that apply unless the partners in the ELP otherwise agree, it is typical for the GP and the LPs to enter into a limited partnership agreement (LPA), which sets out the terms governing the partnership. The LPA does not need to be filed with Companies House and is not publicly available.

The name of an ELP must end with the words 'limited partnership' or the abbreviation 'LP'.

An ELP must be registered at Companies House pursuant to a Form LP5 (for standard ELPs) or Form LP7 (for PFLPs). Form LP5 requires submission of certain basic information, including;

- the name of the ELP;
- its principal place of business;
- the general nature of its business;
- the names of each of the GPs and LPs;
- the term of the ELP; and
- the amount of capital contributed to the ELP by each LP and whether it is contributed in cash or in specie.

Form LP7 requires submission of similar information, save that the general nature of its business, its term and the amount of capital contributed to the ELP by each LP need not be specified. Each form must be signed by each GP and each LP and dated. The form, along with the registration fee of £20 or £100 for same-day registration (applications must be marked as 'same-day service' and submitted by 3pm), must be sent physically to Companies House (there is currently no ability to submit an online application). However, during the covid-19 pandemic, the same-day registration service has not been available. Where there are any changes made to the information submitted in Form LP5 or Form LP7, a Form LP6 must be filed with Companies House detailing the changes within seven days of such changes occurring. There is no fee for filing a Form LP6, but if the filing is made after seven days of such changes occurring, the GP will be subject to a fine of £1 per day for each day beyond such period. In addition, PFLPs are required to advertise in the London Gazette in the event that any GP ceases to act as general partner, ELPs are required to advertise in the London Gazette in the event that any GP becomes an LP, and standard ELPs (but not PFLPs) are required to advertise in the London Gazette in the event that any LP assigns its interest in the ELP, for which a fee of £103.60 plus value added tax is payable.

Once an ELP is registered, Companies House will issue a certificate of registration, which is conclusive evidence that the ELP came into existence on the date of registration and, in respect of PFLPs, has been designated as a PFLP.

Requirements

3 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 on establishment. Accordingly, it is typical for the GP of an ELP on establishment to be an English or Welsh entity. However, there is currently no requirement to maintain a principal place of business in England or Wales following establishment, and, accordingly, the GP may transfer its interest to a GP that is not an English or Welsh entity and the principal place of business of the ELP may be migrated to the jurisdiction of such GP following establishment. However, in December 2018, the UK government issued a response to a consultation on the reform of limited partnerships (2018 CP) in which it stated its intention to require closer ties of limited partnerships to the United Kingdom following establishment. Going forward, ELPs may be required to have a service address in the United Kingdom. However, no legislation has as yet been introduced as a result of the 2018 CP.

An ELP is not required to maintain a local administrator or corporate secretary. In addition, unless the ELP is an alternative investment fund (AIF) for the purposes of Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD), there is no requirement to maintain a custodian. ELPs that are AIFs managed by persons authorised in the United Kingdom as alternative investment fund managers (AIFMs) are required to appoint a depositary to perform certain custody and other functions mandated by the AIFMD.

Unless otherwise agreed between the partners, the books of the partnership must be kept at the ELP's principal place of business. It is typical for the ELP's governing documentation to detail the reporting and accounting requirements applicable to the ELP and how such reports and accounts may be accessed. Unless the ELP is a 'qualifying partnership' for the purposes of the 2013 Regulations, there is no requirement to file accounts with Companies House or make the accounts of the ELP publicly available.

Access to information

4 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?

Certain forms are required to be filed with Companies House, which are publicly available and may be accessed online via the Companies House website. These forms include the names of LPs and, in respect of ELPs that are not PFLPs, the amount of capital contributed to the ELP (which typically represents a small component of their overall commitment to a fund). In 2018, the UK government outlined its intention to require contact information for each LP and each GP, as well as the date of birth and nationality of all LPs and GPs who are natural persons, to be included in filings with Companies House, although no legislation implementing these requirements has as yet been introduced.

Limited liability for third-party investors

5 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 the 1907 Act, LPs in a standard ELP (but not a PFLP) are not permitted to withdraw or otherwise have their contributed capital returned during the life of the ELP. In the event that an LP's capital is withdrawn or otherwise returned during the life of the ELP, such LP will be liable for the debts and obligations of the ELP up to the amount withdrawn or returned. Accordingly, if all amounts contributed by an LP to an ELP are contributed as capital to the ELP, then such LP would potentially remain liable for any distributions up to the amount of such contributions. For this reason, it is typical for private equity funds constituted as standard ELPs to employ a construct where a de minimis amount of an LP's commitment is structured as a capital contribution that is funded by the LP on admission to the ELP, and the remainder is structured as a loan or advance drawn down as and when investments are made, which may then be returned to the LP without being subject to the restriction on return of capital contributed to the ELP. In contrast, LPs in a PFLP are not required to contribute to the capital of the ELP, and the restriction on returning capital contributed by LPs during the life of the ELP does not apply.

In addition, under the 1907 Act, any LP that takes part in the management of the business of an ELP shall be liable for all debts and obligations of the ELP incurred while the LP takes part in the management as though the LP were a GP. The 1907 Act does not contain any guidance on which activities would constitute taking part in the management of the business of an ELP, nor are there any clear guidelines arising from case law on this issue. However, in the context of PFLPs, the 2017 Order specified a white list of activities that an LP in a PFLP may undertake without being deemed to take part in the management of a PFLP and accordingly losing its limited liability status, which includes appointing a representative to a limited partner advisory committee, taking part in a decision approving or authorising an action proposed to be taken by the GP, reviewing or approving valuations of the PFLP's assets and acting as a director, shareholder or agent of the GP provided that as a result, the LP will not be taking part in the management of the PFLP's business.

The white list is not exhaustive and accordingly, LPs make undertake other activities that will not necessarily constitute taking part in the management of the business of the PFLP.

Fund manager's fiduciary duties

6 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?

It is a core principle of English partnership law that each partner in an English partnership owes a duty of utmost good faith to the other partners in the partnership. Under the 1890 Act, the partners in a partnership are also bound by various duties, including to render true accounts and full information on all things affecting the partnership to any partner. The GP of an ELP will accordingly be subject to such duties in managing the business of an ELP and must act in the best interests of the ELP when acting in its capacity as GP. Accordingly, care should be taken when drafting the ELP's governing documents to distinguish between the circumstances when the GP is acting in its capacity as GP of the ELP and accordingly must act in accordance with its fiduciary duties, and when it is acting in a principal capacity and accordingly may act in its own interest. While it may be possible to limit the application of certain fiduciary duties under English law, it is not possible to exclude fiduciary duties that are at the core of the fiduciary relationship, such as the duty of utmost good faith owed between partners. In addition, it is not possible to exclude liability for fraud or dishonesty under English law.

In the event that a separate manager is appointed to manage the ELP, then unless otherwise agreed and subject to such exclusions being permitted by law, such manager will also owe fiduciary duties to the ELP (and the partners therein) in exercising its management functions.

If the GP or separate manager is a UK-authorised AIFM, it will be subject to the duties imposed by the AIFMD, which include a duty to act with due care and skill, a duty to act in the best interests of investors in the ELP and a duty to treat all investors in the ELP fairly (including an obligation to disclose any preferential treatment received by certain investors or classes of investors).

Gross negligence

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

Although under English civil law there is no concept of 'gross negligence', the English courts have consistently accepted that, where the term appears in a contract, they will seek to interpret such term as requiring conduct beyond that of ordinary negligence. However, the English courts have made clear that the meaning of the term 'gross negligence' is a matter for interpretation dependent on the wording of the relevant clause and the context of the contractual arrangements as a whole.

Other special issues or requirements

8 | 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, and special investor governance rights on matters such as removal of the GP or early dissolution of an ELP are all matters typically addressed in the provisions of the ELP's governing documents and will vary from fund to fund. There is no limit on the number of LPs that may participate in an ELP. Typically, the governing documents will require the consent of the GP to effect a transfer of a partnership interest in the ELP. This requirement enables the GP to maintain the ELP's compliance with applicable legal, tax and regulatory requirements, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. It is also typical for the governing documents to provide for withdrawal rights for LPs only in exceptional circumstances (eg, the LP's continued participation in the ELP causing the LP to breach law or regulation).

If the ELP is not a PFLP, an LP will not be permitted to have capital contributed by it to the ELP returned during the life of the ELP, and for this reason, it is typical for the commitment of LPs to a private equity fund structured as an ELP to be split into a de minimis capital and a loan or advance.

It is not currently possible for partnerships formed in other jurisdictions to be converted or redomiciled as ELPs.

Fund sponsor bankruptcy or change of control

9 | 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 insolvency of a GP will normally dissolve the partnership in the absence of an alternative GP having been appointed.

The governing documents for a private equity fund will typically provide that the GP may transfer its interest to other members of the sponsor group, and may also provide for the GP to transfer its interests to persons outside the sponsor group, although this will typically require the consent of LPs representing a majority or supermajority of commitments to the ELP. In addition, the governing documents for a private equity fund structured as an ELP may include certain investor protections in the event that there is a change of control of the GP, such as restricting the ELP's ability to acquire new investments unless a majority or supermajority of commitments to the ELP approves the change of control.

Further, if the GP or manager of the ELP is a UK-authorised firm, it will be subject to the UK statutory regime for the change of control of authorised firms, which requires pre-authorisation from the Financial Conduct Authority (typically considered to be triggered by any acquisition of 10 per cent (20 per cent for AIFMs) or more of the shares or voting rights in the authorised firm).

REGULATION, LICENSING AND REGISTRATION

Principal regulatory bodies

10 | 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 UK rules and regulations governing fund management focus on the regulation of the entity responsible for the management, rather than the funds themselves. Fund managers established in the United Kingdom that provide portfolio and risk management services to funds (alternative investment fund managers (AIFMs)) are required to be authorised and regulated by the Financial Conduct Authority (FCA) pursuant to the UK laws, rules and regulations implementing Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD) and associated regulations.

Post-Brexit, the Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2018 have been issued, under which the United Kingdom continues to apply the substantive requirements of the AIFMD, but with adjustments necessary to apply that law in the United Kingdom as a sovereign state independent of the European Union. It is possible that, in time, UK domestic law will diverge from EU law but for now the AIFMD (as adjusted as referred to above) continues to apply.

Powers of supervision and intervention of the FCA in relation to AIFMs include the powers to:

- access any document in any form and to receive a copy of it;
- require information from any person related to the activities of the AIFM or the alternative investment fund (AIF) and if necessary to summon and question a person;
- carry out on-site inspections with or without prior announcements; and
- require existing telephone and existing data traffic records.

In addition, under the AIFMD, AIFMs are subject to extensive reporting requirements that broadly fall into the following categories:

- pre-investment investor disclosures pursuant to a prescribed list of topics prior to their investment in the AIF;
- annual reporting both to investors in the AIF and the FCA containing audited financial statements, information about any material changes to the pre-investment disclosure and information about the AIFM's remuneration;
- periodic (otherwise known as Annex IV) reporting to the FCA on the matters set out in a prescribed template; and
- notifications to the FCA and other stakeholders in the event that an AIF managed by the AIFM acquires certain holdings or control of non-listed companies that have their registered offices in the United Kingdom.

However, AIFMs that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs) will be subject to a lighter regulatory regime, which does not, for example, require compliance with the majority of the reporting obligations referred to above.

Governmental requirements

11 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 AIFMD is intended to regulate the manager of the fund (ie, the AIFM), rather than the fund. Private equity funds that do not make an offering to the general public are not required to be licensed or registered in the United Kingdom. However, an AIFM must seek approval from the FCA in respect of each new fund under management, which must be accompanied by a copy of the governing documentation for the fund and the prescribed pre-investment disclosures. The FCA has one month to review such an application.

Registration of investment adviser

12 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?

A firm that carries on the regulated activity of managing an AIF as the AIFM is required to be authorised by the FCA. The application process is detailed, and the FCA aims to process an application for authorisation within six months of receiving a complete application. Additional regulatory permissions may be required to the extent that a firm is managing arrangements that are not AIFs, such as separate managed accounts.

The obligations imposed on authorised AIFMs (other than AIFMs that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)) are extensive and include, among others, capital adequacy requirements, rules governing how employees of the AIFM may be compensated, a requirement to appoint a depositary in respect of the assets of each AIF managed by the AIFM and disclosure and reporting requirements, both to investors and the FCA.

Fund manager requirements

13 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?

An authorised AIFM is required to hold minimum capital. The amount of capital depends on whether the AIFs it manages are internally or externally managed and whether the AIFM decides to hold capital for professional indemnity liability or has separate professional indemnity insurance. Private equity funds are normally externally managed. An external AIFM is currently required to have an initial capital of €125,000. Where the value of the portfolios of AIFs managed by the AIFM exceeds €250 million, the AIFM must have an additional amount of own funds equal to 0.02 per cent of the amount by which the value of the portfolios of the AIFM exceeds €250 million, but the required total of the initial capital and the additional amount is capped at €10 million. Where a UK AIFM is authorised to also carry out additional regulated activities (including advising), it would be subject to additional capital rules in respect of its business relating to these additional regulated activities under the UK's new Investment Firms Prudential rules, which are broadly in line with the EU's Investment Firms Regulation and Directive.

As part of the authorisation process, the FCA must be satisfied that the persons who effectively conduct the business of the AIFM are of sufficiently good repute and are sufficiently experienced in relation to the investment strategies to be pursued by the AIFs managed by the AIFM, but there is no specific qualification that must be attained to serve as an officer, director or control person.

The United Kingdom operates a senior managers and certification regime (SM&CR), which applies to firms authorised by the FCA. The FCA has designated particular functions as senior manager functions (SMFs). SMFs include the chief executive function, executive director function, compliance oversight, and money-laundering reporting officer. Anyone who performs an SMF within an authorised AIFM needs to be approved by the FCA before they can perform their role. In addition, the SM&CR requires firms to confirm and certify at least annually that persons performing certain functions that are not SMFs, but which can have a significant impact on customers, the firm or market integrity, are competent to do their job. Persons engaged in investor relations would typically be certification staff.

Political contributions

14 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 in the United Kingdom that would require a private equity fund sponsor to disclose political contributions made by it or its employees outside the UK regimes in respect of political contributions generally, which require UK companies to obtain shareholder approval prior to the making of political donations or expenditure in excess of £5,000 in any 12-month period, and also require political donations or expenditure in excess of £2,000 in any financial year to be included in the directors' reports. In addition, political bodies and candidates may be required to report donations they receive in excess of certain de minimis thresholds to the UK Electoral Commission. Any political contribution made with an intent to secure an advantage may be a criminal offence under the UK Bribery Act 2010.

FUND FORMATION

Use of intermediaries and lobbyist registration

15 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 require such disclosure by a private equity sponsor, although it is typical for the private placement memorandum of a private equity fund to disclose if a placement agent has been appointed in respect of the fund.

Bank participation

16 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.

Directive 2013/36/EU (Capital Requirements Directive IV) (CRD IV) and Regulation (EU) No. 575/2013 (the Capital Requirements Regulation) (CRR) were adopted following the global financial crisis to address the perceived shortcomings of financial institutions. The CRD IV and CRR implement the Basel III agreement, which is designed to improve the amount and quality of capital that banks are required to hold to cover the risks to which they are exposed. This includes enhanced requirements for both quality and quantity of capital, strengthened liquidity and leverage requirements, rules relating to counterparty risk and other macroprudential standards such as countercyclical buffers.

Post-Brexit, the United Kingdom has implemented the Capital Requirements (Amendment) (EU Exit) Regulations 2018, under which the United Kingdom continues to apply the substantive requirements of the CRD IV and CRR. It is possible that, in time, UK domestic law will diverge from EU law, but for now CRD IV and CRR (subject to certain adjustments) continue to apply.

TAXATION

Tax obligations

17 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? Describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

A private equity fund vehicle constituted as an English limited partnership (ELP) would not itself be subject to UK tax in respect of its income and gains. Instead, the income and gains (or losses) of the ELP would be attributed, as and when they arise, to the investors in the ELP according to the investors' entitlement to income and capital as set out in the governing documents of the ELP.

A private equity fund structured as an ELP would not be required to withhold UK tax from distributions to investors. This is on the basis that an ELP is treated as being transparent for UK tax purposes such that, from a UK tax perspective, investors are taxed on their share of the ELP's income and gains as and when such income and gains arise, rather than when the income and gains are distributed to investors. The ELP may, however, be required to withhold UK tax from payments of interest to an investor in respect of a loan made by that investor to the ELP.

Local taxation of non-resident investors

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

Non-resident investors in an ELP should generally not be liable to UK tax on their share of the ELP's income arising from sources in the United Kingdom, except to the extent that UK tax is deducted or withheld from that income at source. Although the United Kingdom does not currently impose withholding tax on dividends, interest is subject to UK withholding tax (currently at the rate of 20 per cent) unless a specific exemption applies or the loan has a term of less than one year.

In addition, non-resident investors in an ELP should not be liable to UK tax on their share of the ELP's gains arising from sources in the United Kingdom, except to the extent the gain arises from the disposal of UK land or certain interests in UK land-rich assets (broadly, vehicles deriving at least 75 per cent of their value from UK land).

This UK tax treatment may not apply if the non-resident investor holds its interest in the ELP as part of a trade (eg, a securities dealer) or if the ELP itself is treated as carrying on a trade for UK tax purposes. Although this will depend on the particular terms and investment strategy of the particular fund, a typical private equity fund that acquires securities in unlisted companies with the intention of holding them as investments will generally be treated as carrying on an investment activity rather than a trade.

Non-resident investors in an ELP should generally not be required to file a UK tax return, although the ELP itself will be required to file a tax return that will include details of the income and gains (or losses) allocated to each investor. This may require a non-resident investor to obtain a unique taxpayer reference number in the United Kingdom, although an exception may apply where the ELP separately reports information about that investor under the Foreign Account Tax Compliance Act or the Common Reporting Standard rules.

Local tax authority ruling

19 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 tax ruling would not normally be sought with respect to the tax treatment of a private equity fund formed in the United Kingdom.

There are various tax rules that may apply to UK resident investors in a private equity fund, particularly in relation to any investments the fund makes outside the United Kingdom. The most significant of these are:

- the controlled foreign companies' rules
- the attribution of gains of non-UK companies' rules,
- the transfer of asset abroad rules; and
- the offshore fund rules.

These rules, among other matters, may subject UK resident investors to tax in the United Kingdom on the income and gains of non-resident companies a private equity fund invests into as and when the income and gains arise (irrespective of whether they are distributed to the private equity fund) and may also require such investors to pay income tax (rather than capital gains tax) on certain gains from the disposal of interests in non-resident companies.

Organisational taxes

20 | 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 establishment of a private equity fund in the United Kingdom.

Special tax considerations

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

A sponsor of a private equity fund structured as an ELP will typically receive returns from the fund in two ways:

- carried interest receipts; and
- an annual management fee.

A significant consideration for a private equity fund sponsor will be to ensure the carried interest receipts are treated as an allocation of partnership profits (rather than a payment akin to a performance fee) so that, to the extent their share of partnership profits represent gains of the ELP from the disposal of its assets, the carried interest is treated as capital gains subject to tax at capital gains tax rates.

However, various law changes since 2015 have been introduced that can undermine this capital gains treatment. In particular, for carried interest holders to maintain capital gains treatment, the average holding period of all of the fund's investments (calculated by reference to the value of those investments) must be at least 40 months. Carried interest will be subject to income tax rates (of up to 45 per cent) if the average holding period is less than 36 months and will be apportioned between income and capital gains tax if the average holding period is between 36 and 40 months.

Carried interest holders will need to consider whether the right to carried interest has any value at the time that it is awarded, particularly if the fund has been in existence for some time before the award is made, and, if so, whether the award could be subject to tax as employment income either when the carried interest is received or when the holder becomes entitled to income and gains from the fund. Some carried interest may be held back to be released (eg, to senior management) in later years. Any such warehousing structures will need careful consideration.

In a typical UK private equity fund, the general partner (GP) will be remunerated for acting as general partner by an allocation of partnership profits by the ELP to the GP (commonly referred to as the priority profit share (PPS)) or, in the earlier years before the fund becomes profitable, a loan from the ELP, which is then set off against future allocations of PPS to the GP. The PPS will generally be taxed in the same way as the investors' share of the ELP's profits such that the UK tax treatment of the PPS will depend on the nature of the profits (eg, dividends, interest or gains) allocated to the GP in satisfaction of the PPS.

Where the GP is also the investment manager, if the GP is a UK company, it should be able to claim a tax deduction for its expenses of an income nature such as salaries of staff.

If the investment manager is an entity in the fund sponsor's group separate from the GP, typically such investment manager will be structured as a company or limited liability partnership that provides management services to, and receives a management fee from, either the GP or the fund itself. The management fee will be taxed as trading income of the investment manager. The disguised investment management fee rules enacted in 2015 seek to ensure that any sums arising to the fund sponsor's management team are taxed as trading income, except to the extent the sums fall within specific exclusions for carried interest and genuine co-investment. Care should be taken when applying these rules as the circumstances in which amounts are treated as 'arising' to the fund sponsor's management team are broad and, in particular, do not require any amounts to actually be received by the individual management team members.

Where the management fee is paid to the investment manager by the GP, the management fee will be funded out of the PPS. If the GP is a UK company, it should be able to claim a tax deduction for the management fee it pays to the investment manager. Where the management fee is instead paid to the investment manager by the fund itself, UK corporate tax-paying investors in the fund may be entitled to claim a tax deduction for their share of the management fee as an expense of management of their investment business.

The UK tax treatment of carried interest, PPS and management fees is a complex area that is heavily fact-dependent, and specialist advice should be taken at an early stage when structuring funds with a UK nexus.

Tax treaties

22 | List any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

The United Kingdom is a party to a significant number of tax treaties. However, a private equity fund structured as an ELP will typically not be entitled to rely on the benefits provided in the tax treaties to which the United Kingdom is a party on the basis that such a fund will generally be transparent for UK tax purposes. An investor in the fund may, however, be entitled to rely on one of the UK's tax treaties in relation to their share of the fund's income and gains to the extent such income and gains have a source in the United Kingdom (where the investor is not resident in the United Kingdom) or where the investor is resident in the United Kingdom (and the income and gains arise outside the United Kingdom).

Other significant tax issues

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

The main area of focus is likely to be the value added tax (VAT) treatment of fees payable in the structure. The GP in an ELP would normally be remunerated through a priority profit share, which should not attract VAT. VAT would generally be levied on annual management fees charged by a separate investment manager, although it may be possible to avoid such VAT, for example, by taking advantage of the VAT grouping rules.

Private equity funds and their sponsors will also need to give consideration to any tax reporting required under regimes such as the Common Reporting Standard rules and the EU's and Organisation for Economic Co-operation and Development's (OECD) mandatory disclosure regime. A fund structured as an ELP will generally be required to obtain information about investors who are tax resident in the European Union or in jurisdictions with which the United Kingdom has entered into an agreement to exchange information automatically and report that information to HMRC. A fund sponsor based in the United Kingdom or the European Union may also be required to report information to their domestic tax authorities pursuant to the EU's and OECD's mandatory disclosure regime concerning certain cross-border tax-planning arrangements.

Another area of focus for a private equity fund structured as an ELP will be its "under-the-fund" structuring and, in particular, whether to use one or more holding companies to acquire its investments and the location of any such holding companies. In this regard, it is worth noting that the UK government has published draft legislation designed to provide significant tax benefits for qualifying asset holding companies held by qualifying funds and certain other investors. This development will be of interest to private equity funds that wish to hold their underlying investments through a UK holding company. If the draft legislation is enacted in its current form, qualifying UK asset holding companies would benefit from a broad range of tax reliefs, for example, an exemption for capital gains on the disposal of investments (other than investments in UK land-rich companies), an exemption from UK withholding tax on interest, the ability to deduct profit participating interest and the ability to repatriate gains by way of a share buyback without jeopardising capital gains tax treatment for investors.

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 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 the Financial Services and Markets Act 2000 (FSMA 2000), there is a general restriction on anyone who is not an authorised person communicating, in the course of business, an invitation or inducement to engage in investment activity and a restriction on promoting interests in unregulated collective investment schemes (which would typically include private equity funds structured as English limited partnerships (ELPs)).

Alternative investment fund managers authorised by the Financial Conduct Authority (FCA) are not subject to the financial promotion restriction, but are prohibited from promoting interests in an unregulated collective investment scheme, unless an exclusion applies. Such exclusions include a UK-authorised AIFM marketing to 'professional investors' (generally, institutional investors and certain types of family offices and other persons who are capable of electing to be treated as professional investors because they meet certain restrictive criteria based on their knowledge and experience) and, in respect of certain strategies, to certain high net worth and sophisticated investors in the United Kingdom.

A non-UK fund manager would typically be a non-authorised person for the purposes of FSMA 2000 and providing marketing materials or offering documents for a private equity fund to a prospective investor in the United Kingdom would constitute a prohibited financial promotion unless an exclusion applies. Such exclusions include a non-UK fund manager marketing to professional investors pursuant to the UK's national private placement regime. If a non-UK fund manager is seeking to market a fund in the United Kingdom under the national private placement regime, it must notify the FCA using an online form that contains certain general information about the fund manager and the fund, and it will also be subject to certain ongoing reporting requirements to investors and to the FCA, as well as notification and disclosure requirements in the event that the fund acquires or disposes of a substantial stake in a UK non-listed company, and restrictions on certain capital distributions if the fund acquires control of a UK company.

For the above purposes, a fund manager will be 'marketing' in the United Kingdom if it (or someone on its behalf) is making a direct or indirect offering or placement of units or shares in a fund it manages to investors domiciled or with a registered office in the United Kingdom.

Given that 'marketing' is an activity that must be at the initiative of the manager, where an investor seeks information about a private equity fund strictly at its own initiative, the manager would not be regarded as marketing in the United Kingdom.

However, the financial promotion restriction and the restriction on the promotion of unregulated collective investments schemes under FSMA 2000 predate the transposition of Directive 2011/61/EU (Alternative Investment Fund Managers Directive) into UK law. Accordingly, even if a fund manager is not 'marketing' the fund in the United Kingdom, care should be taken that it is not making a financial promotion or promoting an unregulated collective investment scheme in the United Kingdom without the benefit of an exclusion.

Types of investor

25 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 technically no restriction on the type of investor that may participate in a private equity fund, but there is a restriction on the categories of person to whom sponsors of a private equity fund are permitted to promote or market that fund in the United Kingdom. A UK-authorised AIFM is entitled to market (and promote) an alternative investment fund (AIF) under its management to 'professional investors' (generally, institutional investors and certain types of family offices and other persons who are capable of electing to be treated as professional investors because they meet certain restrictive criteria based on their knowledge and experience) in the United Kingdom.

Although the United Kingdom does allow the promotion of certain types of funds to other categories of persons, such as high-net-worth individuals and sophisticated investors, it is common to restrict participation in an AIF to professional investors (including those who may, on request, be treated as professional investors) to remain outside the scope of Regulation (EU) No. 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation). An interest in a private equity fund is a packaged retail and insurance-based investment product and thus if it is made available to a retail client, the sponsor must provide, publish and maintain on its website a key information document (KID). A KID must be in prescribed form and must include information prepared in accordance with regulatory technical standards.

Identity of investors

26 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 the limited partners (LPs) in an ELP is required to be specified in Form LP5 or Form LP7 on establishment of the ELP, and any changes in the composition of the LPs in an ELP (including by way of transfers of interest) are required to be specified in a Form LP6 submitted within seven days of such change occurring. Each Form LP5, LP7 and LP6 filed with Companies House is publicly available and may be accessed online via the Companies House website. ELPs are required to advertise in the London Gazette in the event that any general partner (GP) becomes an LP, and 'standard' ELPs (but not private fund limited partnerships) are required to advertise in the London Gazette in the event that any LP assigns its interest in the ELP. Form LP6 would also be required to be filed in the event of a change of GP of an ELP.

In addition, if the GP or manager of the ELP is a UK-authorised firm, it will be subject to the UK statutory regime for the change of control of authorised firms, which requires pre-authorisation from the FCA in respect of a change of control of an authorised firm.

Licences and registrations

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

If the person offering interests in a private equity fund is an AIFM authorised by the FCA, then no additional licences or registrations are required to offer interests in a private equity fund to persons in the United Kingdom. If the person offering interests in the private equity fund is not so authorised, it must rely on the UK's national private placement regime, pursuant to which it must file a notification with the FCA using an online form that contains certain general information about the fund manager and the fund, and it will also be subject to certain ongoing reporting and notification requirements.

Money laundering

28 | 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 current UK regime regulating money laundering and terrorist financing is set out in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the MLRs) as amended by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 implementing EU directives and will remain in effect post-Brexit, with adjustments necessary to make that body of law operate properly in the United Kingdom as a sovereign state independent of the European Union. However, it is possible that, in time, UK domestic law will diverge from EU law.

In the United Kingdom, the Joint Money Laundering Steering Group publishes comprehensive industry guidance, including guidance for private equity firms.

In the United Kingdom, firms subject to the MLRs are required to implement effective procedures for detecting money laundering but may adopt a risk-based approach to customer due diligence (CDD), with the application of enhanced due diligence (EDD) where the customer presents a higher risk. Higher risk situations include a business relationship with persons that do not involve face-to-face interactions, dealing with politically exposed persons or dealing with investors from third countries designated as high risk. In such circumstances, firms must apply EDD measures to manage and mitigate the associated risks, including:

- gathering additional information on the customer and beneficial owners;
- obtaining senior management approval for establishing or continuing the business relationships; and
- conducting an enhanced level of monitoring.

Firms are obliged to verify customers' identities on the basis of documents, data or information obtained from an independent and reliable source and to take reasonable steps to understand their customers' beneficial ownership and control structure (including, for these purposes, identifying any natural person holding more than 25 per cent ownership interest) and to document the CDD measures they have taken.

Staff of authorised firms must file a report with the National Crime Agency (NCA) if they know or suspect, or have reasonable grounds for knowing or suspecting, that a person is engaged in money laundering or terrorist financing. Such a report would include the identity of the relevant person. The firm must obtain consent from the NCA before proceeding with a suspicious transaction or entering into the relevant business arrangements. It is a criminal offence to tip-off another person that a disclosure has been made or prejudice an investigation.

EXCHANGE LISTING

Listing

29 | 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 it is possible for private equity funds to list on certain securities exchanges in the United Kingdom such as the London Stock Exchange's main market and its specialist funds segment, this is by no means customary for private equity funds. Although listing would provide sponsors with the benefits of a potential increased pool of capital (given that retail investors may invest in listed securities), the increased regulatory, administrative and reporting burdens created by the requirements to comply with UK legislation applicable to UK listed companies make listing an unattractive option for most private equity fund sponsors. In the event that a private equity fund sponsor does intend to list a private equity fund, it is typical for such a fund to be structured as a company rather than an English limited partnership.

Restriction on transfers of interest

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

In principle, subject to certain limited exceptions, shares in companies admitted to a UK securities exchange must be free from any restriction on the right of transfer. However, the UK listing authorities have permitted UK-listed entities to include restrictions on transfers of their shares to prevent them falling within the scope of onerous overseas legislative requirements. However, the UK listing authorities have stated that such provisions must be carefully drafted so that they identify the specific legislative provisions in question, and restrictions that are drafted in general or catch-all terms will not be permitted.

PARTICIPATION IN PRIVATE EQUITY TRANSACTIONS

Legal and regulatory restrictions

31 | 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?

English limited partnerships (ELPs) do not have a separate legal personality and accordingly cannot hold property in their own right or enter into contracts on their own behalf. Accordingly, ELPs act through their general partners or managers as agents of the ELP, who will hold the property of the ELP on trust (or, less commonly, a nominee company may be appointed to hold such property as the ELP's nominee).

In addition, alternative investment fund managers (AIFMs) authorised in the United Kingdom (other than sponsors that manage alternative investments fund (AIFs) whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)), and non-UK fund managers who have marketed to investors in the United Kingdom under the national private placement regime, are also subject to the asset-stripping rules set out in Directive 2011/61/EU (Alternative Investment Fund Managers Directive) (AIFMD), which prohibit certain types of capital distributions in the event that the relevant fund acquires control of a UK non-listed company for a period of 24 months following the acquisition of control.

FUND FORMATION

FUND FORMATION

Compensation and profit-sharing

32 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.

Sponsors authorised in the United Kingdom to manage AIFs (other than sponsors that manage AIFs whose assets do not exceed, on an aggregated basis, €100 million (or €500 million for closed-ended unleveraged AIFs)) are subject to the remuneration code set out in the Financial Conduct Authority (FCA) Handbook (the Remuneration Code) and to the ESMA Guidelines on sound remuneration policies under the AIFMD (the Guidelines) (which have been retained in UK law following Brexit). Sponsors that have permissions in addition to managing AIFs may be subject to additional remuneration requirements.

Under the Remuneration Code, an AIFM must implement and maintain remuneration policies for relevant staff (code staff) that promote sound and effective risk management and do not encourage risk-taking that is inconsistent with the risk profile of the AIFs it manages. Code staff include:

- senior management;
- risk-takers;
- control functions; and
- any employees receiving compensation that takes them into the same remuneration bracket as senior management.

The remuneration policy must take into account a number of principles set out in the Remuneration Code, including providing guaranteed remuneration, balancing fixed and variable remuneration, ensuring early termination payments do not reward failure, and the payout process rules (which prescribe, among other things, that at least 50 per cent of variable remuneration must be paid out in interests in the AIF, that at least 40 per cent of variable remuneration must be deferred for a period of at least three years, and that variable remuneration is subject to vesting and a comprehensive adjustment mechanism for all risks to the financial situation of the AIFM).

However, an AIFM is expected to comply with the Remuneration Code in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities, and the FCA has published guidance to assist firms in applying the payout process rules in a proportionate manner.

AIFMs are also required to disclose certain information about the remuneration of their code staff in the AIF's annual report.

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Following Brexit, various strategies were employed to enable marketing of funds by UK managers in the European Union, including seconding employees to a firm authorised in the European Union, seeking appointment as a tied agent of an EU-authorised investment firm or to obtain cross-border licences in jurisdictions that permit it. Both the secondment and tied agent models are under increasing regulatory scrutiny, and the introduction of the pre-marketing regime under Directive (EU) 2019/1160 with regard to cross-border distribution of collective investment undertakings has reduced the attractiveness of obtaining cross-border licences in those jurisdictions where non-EU alternative investment fund managers (AIFMs) are unable to pre-market. Marketing strategies employed by UK managers targeting EEA investors are likely to continue to require careful analysis in this changing landscape.

The United Kingdom did not implement Regulation (EU) 2019/2088 (the Sustainable Finance Disclosure Regulation) but has been legislating and consulting on its own sustainability requirements. It has made rules on mandatory climate-related public disclosures based on the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations to be made by asset managers, including UK AIFMs and UK advisers in private equity structures. The largest asset managers (with more than £50 billion AUM) will need to make their first disclosures by 30 June 2023. Firms with less than £5 billion under management are exempt. In addition, the United Kingdom intends to:

- establish a new sustainability disclosure regime building on TCFD to require additional sustainability disclosures (beyond climate); and
- propose a UK green taxonomy, in respect of which it is unclear to what extent the United Kingdom will diverge from the EU Taxonomy Regulation and associated Delegated Acts.

The United Kingdom is also considering introducing new rules to improve diversity in financial services firms.

The United Kingdom has introduced a new type of fund vehicle called the Long-Term Asset Fund, which is an authorised open-ended alternative investment fund created to facilitate investment in long-term, illiquid assets, such as venture capital and private equity. It must be managed by a UK authorised AIFM and may invest in UK and non-UK assets but it must invest at least 50 per cent in unlisted securities and other long-term assets.

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FORMATION

Forms of vehicle

1 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 United States. 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.

Forming a private equity fund vehicle

2 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 earlier).

Requirements

3 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 for a professional service provider to act in these capacities. 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 generally maintain client assets with a qualified custodian to comply with the requirements of Rule 206(4)-2 (the custody rule) thereunder.

Access to information

4 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 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.

Limited liability for third-party investors

5 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 (eg, a subscription agreement) to which they are a party.

Fund manager's fiduciary duties

6 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 Securities and Exchange Commission (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 embodied in the anti-fraud provisions of section 206 of the Advisers Act.

In June 2019, the SEC published an interpretation of the standard of conduct for investment advisers (the Interpretation). The Interpretation stated that the Advisers Act fiduciary duty requires that an adviser, at all times, serve the best interest of its client and that this overarching obligation to act in a client's best interest encompasses both a duty of care and a duty of loyalty. According to the Interpretation, the duty of care consists of the duty to:

- provide advice in the best interest of the client;
- seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades; and
- provide advice and monitoring over the course of the client relationship.

The duty of loyalty requires that an adviser not place its own interest ahead of its client's interests. The Interpretation reaffirmed that, to fulfil its duty of loyalty, an adviser must:

- make full and fair disclosure to its clients of all material facts relating to the advisory relationship and all conflicts of interest that might incline an adviser – consciously or unconsciously – to render advice that is not disinterested; and
- obtain a client's informed consent to such facts and conflicts.

Moreover, the Interpretation indicated that the Advisers Act fiduciary duty follows the contours of the adviser's relationship with its client and that the adviser and client may shape that relationship by agreement, provided that there is full and fair disclosure and informed consent.

Gross negligence

7 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.

Other special issues or requirements

8 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. 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 United States will qualify for exemption from registration under the Investment Company Act of 1940, as amended, 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 United States, the staff at the SEC has taken the position that only US investors must be analysed for the purposes of making that same determination (assuming certain other requirements are met).

Section 12(g) of the Securities Exchange Act of 1934, as amended (the Exchange Act) generally requires 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. This section has the practical effect of imposing a limit of 1,999 investors in any single US-domiciled private equity fund. In addition, Rule 12g3-2(a) under the Exchange Act provides 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 United States. Rule 3b-4(c) under the Exchange Act provides that a private equity fund that is organised outside of the United States generally qualifies as a foreign private issuer unless more than 50 per cent of its outstanding voting securities are held by US residents and any of the following applies:

- 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 United States; or
- its business is administered principally in the United States.

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).

Fund sponsor bankruptcy or change of control

9 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, eg, 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 and those required to be registered 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 often 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

Principal regulatory bodies

10 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

Under US Investment Advisers Act of 1940 (the Advisers Act), the Securities and Exchange Commission (SEC) has the authority to regulate investment advisers, defined as any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. 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 that 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 United States as an investment adviser or advising registered funds, have no US place of business, have fewer than 15 US clients and US investors in total in private funds, and have assets under management (AUM) from such US clients and US investors of less than US$25 million; and
- the private fund adviser exemption: investment advisers solely to qualifying private funds with AUM of less than US$150 million.

However, for an investment adviser whose 'principal office and place of business' is outside the United States, the private fund adviser exemption provides that such an 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 United States are solely attributable to private fund assets, the total value of which is less than US$150 million.

AUM includes 100 per cent of any securities portfolios or private funds for which an investment adviser provides continuous and regular supervisory or management services, regardless of the nature of the assets held by the portfolio or the private fund. In addition, AUM includes 100 per cent of any uncalled capital commitments to private funds and any securities portfolios that consist of proprietary assets or assets managed without receiving compensation.

In determining whether an investment adviser can rely on the private fund adviser exemption, the SEC considers an investment adviser's principal office and place of business as the location where the investment adviser controls, or has ultimate responsibility for, 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 United States must count all private fund assets, including those from non-US clients, toward the US$150 million limit in calculating AUM. An investment adviser with its principal office and place of business outside of the United States need only count private fund assets it manages at a place of business in the United States toward the US$150 million limit. The key to determining whether an adviser is managing assets at a US place of business is whether activities are being conducted there that are intrinsic to providing investment advisory services such as regular communications with clients or 'continuous and regular supervisory and management services'. An investment adviser provides 'continuous and regular supervisory or management services' with respect to a private fund at a place of business in the United States 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 United States makes independent investment decisions and implements those decisions. Therefore, a private fund adviser with its principal office and place of business outside of the United States that cannot meet the terms of the foreign private adviser exemption because it has raised more than US$25 million from US investors can often rely on the private fund adviser exemption because the number of non-US clients and the amount of assets managed outside of the United States are not taken into account when calculating the AUM of an investment adviser with its principal office and place of business outside the United States.

Investment advisers relying on the venture capital fund adviser 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 investment 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 if the disclosure for certain specific items becomes inaccurate. 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 staff 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. Investment advisers relying on the foreign private adviser exemption are not required to file reports with the SEC. In addition to the aforementioned exemptions, certain investment advisers are excluded from the definition of 'investment adviser' and thus are not required to register under the Advisers Act or report with the SEC as an ERA. 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 in 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 at least US$150 million of 'private fund' (ie, a fund relying on 3(c)(1) or 3(c)(7)) of the AUM is required to file Form PF with the SEC, which requires disclosure of certain 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. Registered investment advisers to hedge funds are also required to report additional information about the hedge funds they advise, including fund strategy, counterparty credit risk and use of trading and clearing mechanisms. Large private fund advisers are required to report more extensive information, with the nature of the information dependent upon their strategy. Additional disclosure requirements apply to registered investment advisers to private equity funds with at least US$2 billion in AUM (ie, large private equity advisers). Such disclosure requirements focus on fund guarantees of controlled portfolio company obligations, leverage of controlled portfolio companies and use of bridge financing for controlled portfolio companies. In addition, registered investment advisers to hedge funds with at least US$1.5 billion in AUM (ie, 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, real estate funds and venture capital funds (as well as registered investment advisers to hedge funds that have a smaller AUM), 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 the Freedom of Information Act. 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 private fund that is required to pay a performance fee based on unrealised gains to its investment adviser or that may borrow in excess of certain thresholds or sell assets short (other than for the purpose of hedging currency exposure or managing duration) is deemed to be a per se hedge fund and therefore will be required to fulfil the Form PF reporting obligations applicable to hedge fund advisers.

The SEC has proposed rules regarding Form PF that would require covered advisers to disclose additional categories of information on Form PF than required historically, and with respect to certain triggering events require filing within one business day thereafter. Such proposed rules would lower the threshold for what constitutes a large private equity adviser, from US$2 billion in AUM to US$1.5 billion in AUM.

Regulation applicable to unregistered advisers

Even unregistered investment advisers (whether ERAs or not) are subject to the general anti-fraud provisions of the Securities Exchange Act of 1934, as amended (the Exchange Act), the Advisers Act, state laws and, if required to register as a broker-dealer with the Financial Industry Regulatory Authority (FINRA), 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 regulation

The US Commodity Futures Trading Commission regulation (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 or its adviser (typically the investment adviser) to be subject to CFTC jurisdiction as a CTA, and, unless an exemption is available, 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, business development companies, 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', real estate investment trusts and business development companies), 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' and 'non-United States persons') in a private offering of securities (including an offering that complies with Rule 506(c) under the Securities Act)), and corresponding exemptions are available to CTAs of private equity funds. Notably, beginning in September 2020, the 'de minimis' exemption under CFTC Rule 4.13(a)(3) was revised to prohibit sponsors from relying on the exemption if the sponsor or any of its 'principals' is subject to certain specified covered statutory disqualifications. Both US and non-US private equity fund sponsors should 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 the extent applicable, sponsors should assess the registration requirements for CPOs and determine whether they can rely on an 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.

Governmental requirements

11 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 to enable the funds to qualify for exemption from regulation as investment companies under the Investment Company Act of 1940, as amended (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 value of any class of equity interests in a private equity fund is held by 'benefit plan investors' (disregarding the value of interests held by the sponsor and its affiliates, and anyone providing investment advice to the private equity fund and its affiliates, unless they themselves are 'benefit plan investors'), 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). In general, for purposes of applying the 25 per cent test, the term 'benefit plan investors' includes only those plans and arrangements that are subject to the fiduciary responsibility standard of care under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) or the prohibited transaction rules under Title I of ERISA or section 4975 of the Internal Revenue Code of 1986 (the Code), such as US corporate pension plans and individual retirement accounts as well as entities whose assets include 'plan assets' (eg, a fund of funds). Plans that are not subject to the fiduciary responsibility standard of care under Title I of ERISA or the prohibited transaction rules under Title I of ERISA or section 4975 of the Code, such as US governmental pension plans and pension plans maintained by, or contributed to by, non-US corporations, are not counted for purposes of the 25 per cent test. 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. Qualification as a REOC 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 real estate that is managed or developed and with respect to which the private equity fund has the right to, and in the ordinary course of its business does, substantially participate directly in the management or development activities.

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.

Registration of investment adviser

12 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.

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, operation and marketing of their business, as well as periodic compliance inspections conducted by the SEC.

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 full and fair pre-commitment disclosure and consent from investors (including for overhead expenses and for the compensation of operating partners, senior advisers, consultants and seconded and other in-house 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, co-investment vehicles, employee side-by-side vehicles, or friends and family funds without full and fair pre-commitment disclosure and consent from investors;
- marketing presentations, and the presentation of performance information generally (eg, the adequacy of disclosures regarding the impact of fund-level leverage on presented performance results);
- receipt by private equity firms of compensation from funds or portfolio companies, or both, which is outside the typical management fee or carried interest structure without a corresponding management fee offset, without full and fair pre-commitment disclosure and consent 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;
- fee-sharing arrangements with co-investors whereby a portion of fees received from portfolio companies are shared with such co-investors and the impact of such arrangements on management fee offsets;
- disclosure of other conflicts of interests to investors, including those arising out of the outside business activities, affiliate relationships and personal financial dealings 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 full and fair pre-commitment disclosure and consent 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 full and fair pre-commitment disclosure and consent from investors;
- allocation of interest from a loan to the private equity fund adviser only to the adviser or its affiliates without full and fair pre-commitment disclosure and consent from investors;
- pay-to-play rule violations;
- late submission of required filings (eg, Form PF);
- policies and procedures relating to the receipt of material;
- non-public information; and
- fund restructurings.

Fund manager requirements

13 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 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). In addition, broker-dealers are subject to a prescriptive set of rules as well as certain conduct requirements including Regulation Best Interest. 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 there are 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.

Political contributions

14 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 Jersey, New Mexico and New York) have enacted legislation and certain US public pension plans (including the California Public Employees' Retirement System, the California State Teachers' Retirement System, 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.

Use of intermediaries and lobbyist registration

15 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.

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.

Bank participation

16 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 (the agencies) 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). On 24 May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the Reform Act) was enacted and, among other financial regulatory changes, modified the Volcker Rule's 'banking entity' definition. For purposes of the Volcker Rule, as implemented by the Final Rules and as amended by the Reform Act, the term 'banking entity' means any insured depository institution (other than certain limited-purpose trust institutions and insured depository institutions that do not have, and are not controlled by a company that has, more than US$10 billion in total consolidated assets and total trading assets and trading liabilities that are more than 5 per cent of total consolidated assets), any company that controls such an insured depository institution, any company that is treated as a bank holding company for purposes of the International Banking Act (eg, 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 on a per-fund basis, or 3 per cent of the banking entity's 'Tier 1 capital' on an aggregate basis, and provided that certain other conditions are met. For these purposes, covered funds 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, subject to certain exclusions.

In 2019, the agencies responsible for implementing the Volcker Rule adopted certain targeted amendments to the Volcker Rule regulations to simplify and tailor certain compliance requirements relating to the Volcker Rule. In 2020, the agencies adopted additional revisions to the Volcker Rule's current restrictions on banking entities sponsoring and investing in certain covered hedge funds and private equity funds, including by proposing new exemptions allowing banking entities to sponsor and invest without limit in credit funds, venture capital funds, customer facilitation funds and family wealth management vehicles (the Covered Fund Amendments). The Covered Fund Amendments also loosen certain other restrictions on extraterritorial fund activities and direct parallel or co-investments made alongside covered funds. The Covered Fund Amendments should therefore expand the ability of banking entities to invest in and sponsor private funds.

TAXATION

Tax obligations

17 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? 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. However, liability for adjustments to a fund's tax returns may be imposed on the fund itself in certain circumstances in the absence of an election to the contrary.

If the fund generates effectively connected income (ECI) with the conduct of a US trade or business, 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. Gain or loss from the sale or exchange of an interest in a fund by a foreign partner will be considered ECI and therefore subject to US tax to the extent that such partner would have been allocated ECI if the fund sold all of its assets at fair market value as of the date of the sale or exchange. The transferee of an interest in a partnership engaged in a US trade or business to withhold 10 per cent of the amount realised by the transferor on the sale or exchange, and the fund would be required to withhold from future distributions to the transferee if the transferee fails to properly withhold. Funds that hold investments that generate ECI often allow non-US investors to participate through one or more entities treated as corporations for US tax purposes with respect to such investments, in which case such corporations would file US tax returns and pay tax associated with such ECI investments. Non-US investors may still be subject to US withholding tax on dividends or interest paid by such corporations.

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 United States 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.

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. 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. 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.

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.

Local taxation of non-resident investors

18 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 United States 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'). 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.

Local tax authority ruling

19 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 United States. 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.

Organisational taxes

20 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 United States.

Special tax considerations

21 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.

Under section 1061 of the Internal Revenue Code of 1986 (the Code), 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, and this requirement may implicate gains with respect to capital contributions made by sponsors and their employees. 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.

Tax treaties

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

The United States 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.

Other significant tax issues

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

Tax reform legislation enacted in 2017 (the Tax Reform Bill) has resulted in fundamental changes to the 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;
- 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.

SELLING RESTRICTIONS AND INVESTORS GENERALLY

Legal and regulatory restrictions

24 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 United States will satisfy the requirements necessary to avoid registration of the interests in the fund with the Securities and Exchange Commission (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. Offers and sales of securities that comply with Regulation D will not be deemed to be a transaction that involves a public offering. The applicability of the exemptions will depend on the manner of the offering. Under the Rule 506(b) exemption, the private equity fund sponsor must not make any offers or sales by means of general solicitation or general advertising. In addition, the private equity fund cannot have more than 35 non-accredited investors. Each such non-accredited investor, either individually or with a representative, must also be sophisticated (ie, must have sufficient knowledge and experience in financial or business matters to make them capable of evaluating the merits and risks of the potential investment).

Under the Rule 506(c) exemption, the private equity sponsor may broadly solicit and generally advertise the offering, so long as, among other requirements, 'reasonable steps' are implemented to ensure that each investor in the private equity fund is an accredited investor at the time of the sale of securities to that investor.

An 'accredited investor', as defined in Rule 501 under Regulation D, generally includes:

- a natural person with a net worth (either individually or jointly with a spouse or spousal equivalent) of more than US$1 million or income above US$200,000 in the past two years (or US$300,000 in joint income with a spouse or spousal equivalent for those two years and a reasonable expectation of reaching the same income level in the current year);
- a natural person holding one or more of the following certifications in good standing:
  - General Securities Representative licence (Series 7);
  - Private Securities Offerings Representative licence (Series 82); or
  - Investment Adviser Representative licence (Series 65);
- any natural person who is a 'knowledgeable employee', as defined in rule 3c5(a)(4) of the Investment Company Act of 1940, as amended (the Investment Company Act); and
- certain entities with more than US$5 million in total assets.

For the purposes of the aforementioned US$1 million net-worth test, 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 estimated 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 amount of such incremental indebtedness must be treated as a liability for the net worth calculation. 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.

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.

Although the SEC recently indicated that, in certain circumstances, the 'reasonable steps determination' may not be substantially different from an issuer's development of a 'reasonable belief' for purposes of Rule 506(b), 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 relying on the Rule 506(c) exemption, and this exemption is not expected to play a significant role in private equity fundraising in the future.

Another factor impeding utilisation of the Rule 506(c) exemption by private equity firms is that the use of general solicitation in reliance on Rule 506(c) may affect other aspects of a private equity sponsor's regulatory compliance regime. 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 exemption 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 date of 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 the 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 exemption.

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 date of first sale in the state. Anti-fraud provisions under applicable state laws apply despite the pre-emption described earlier.

Under Rule 506(d), issuers are prohibited from relying on the Rule 506 exemptions (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, eg, 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 in any capacity at the time of the sale and any persons compensated (directly or indirectly) 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 these '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. A number of these disqualifying events are required to occur in connection with the purchase or sale of securities and include a look-back period of five to 10 years depending on the particular facts surrounding the disqualifying event. Disqualification is not triggered by actions taken in jurisdictions other than the United States. While only disqualifying events that occur after the rule's effective date (23 September 2013) will disqualify an issuer from relying on a Rule 506 exemption, Rule 506(e) provides that 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 within a reasonable time prior to such sale. Under Rule 506(e), a failure to provide this disclosure will not prevent an issuer from relying on a Rule 506 exemption 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 into whether any disqualifications exist. This factual inquiry will depend on the facts and circumstances concerning, among other things, the issuer and the other offering participants. 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, the fund must be excluded from the definition of investment company. Under section 3(c)(7) of the Investment Company Act, each investor in the fund will typically be required to represent that it is a qualified purchaser. In the event that not all of a private equity fund's investors are qualified purchasers, the fund may still be excluded from the definition of an 'investment company' under section 3(c)(1) of the Investment Company Act by limiting the number of investors to not more than 100 (all of which must still be accredited investors for Regulation D purposes and with respect to which certain 'look through' attribution rules apply). A qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act generally includes a natural person (or a company owned directly or indirectly by two or more natural, related persons) 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 in the aggregate owns and invests on a discretionary basis not less than US$25 million in investments and certain trusts. To rely on section 3(c)(1) or 3(c)(7), a private equity fund sponsor must not be making or presently proposing to make a public offering. One way that a sponsor can meet this requirement is by complying with Regulation D, as mentioned earlier.

Certain rules under the Investment Company Act provide additional clarification for the above requirements. Rule 3c-5 under the Investment Company Act provides that 'knowledgeable employees' (namely, executive officers and directors of the sponsor and most investment professionals who, as part of their regular functions or duties, have been participating in the private equity fund's investment activities, or substantially similar functions or duties for another fund, for at least 12 months) are ignored for the purposes of the 100-person limit for purposes of section 3(c)(1) and the qualified purchaser requirement for purposes of section 3(c)(7). Similarly, for funds organised outside the United States, the SEC staff has taken the position that non-US investors are generally ignored for purposes of the 100-person limit of section 3(c)(1) and the qualified purchaser requirement of section 3(c)(7).

For real estate funds, section 3(c)(5)(C) of the Investment Company Act provides another exclusion from the definition of 'investment company' for any issuer who is primarily engaged in purchasing and acquiring mortgages or other liens on and interests in real estate.

If the sponsor of a private equity fund is a registered investment adviser under the Investment Advisers Act of 1940, as amended (the Advisers Act), then in circumstances where the sponsor charges a fee that is based in part on the capital appreciation of the underlying investments, each investor may need to represent that it is a 'qualified client' as defined in Rule 205-3 under the Advisers Act. A qualified client generally includes a natural person or company with a net worth exceeding US$2.2 million or that has US$1.1 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 mentioned earlier). A qualified client also includes both qualified purchasers as defined in the Investment Company Act and nearly all persons that fall under the 'knowledgeable employee' definition above (with the exception of an advisory board member, who is not included in the definition of 'qualified client').

Types of investor

25 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).

US persons and entities, including US private equity funds, are subject to sanctions laws and regulations that are principally administered by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury. These sanctions laws and regulations prohibit, among other things, certain types of transactions and dealings with designated countries, territories, entities and individuals such as those listed on OFAC's Specially Designated Nationals and Blocked Persons List. These sanctions programmes may prohibit the fund from admitting investors who are the subject of sanctions, or are located in a country or territory that is embargoed. Depending upon the fund's geographic scope, it may also be subject to similar sanctions programmes implemented in other jurisdictions. Relatedly, private equity funds ordinarily implement anti-money laundering procedures to diligence potential investors and their source of funds to ensure compliance with these and other laws and regulations.

Otherwise, as a general matter, there are no such restrictions other than those imposed by applicable securities laws described earlier or that 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). Further, funds may elect to limit or forgo investments from persons or countries that could introduce additional regulatory risks relating to oversight from governmental authorities such as the Committee on Foreign Investment in the United States and the Defense Counterintelligence and Security Agency, among others. There are also recently enacted restrictions on bank holding companies investing in private equity funds.

Identity of investors

26 | 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 exempt reporting adviser, 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.

Licences and registrations

27 | 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 United States would not be required to register as a broker or dealer under the Securities Exchange Act of 1934, as amended (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. 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. On 7 October 2020, the SEC voted (three to two) in favour of proposing an exemptive order granting certain 'finders' conditional exemption from broker-dealer registration. If adopted, this proposal would permit qualifying finders to receive transaction-based compensation without having to register as a broker under the Exchange Act. As of this writing, this proposal has not yet been adopted.

Money laundering

28 | 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 to address these issues. These practices include the following:

- developing internal policies, procedures and controls, including with respect to the establishment of the identity of each investor, any beneficial owners, and their source of funds, and to ensure compliance with economic sanctions and other applicable laws and regulations;
- 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 the Financial Industry Regulatory Authority.

In December 2020, the US Congress voted to override a Presidential veto to enact a statute containing the Corporate Transparency Act, which, when fully implemented by forthcoming regulations, will significantly alter anti-money laundering compliance obligations within the United States, including by creating a beneficial ownership registry within FinCEN and requiring 'reporting companies' to report information on their beneficial owners to FinCEN. Although private equity firms generally do not appear to qualify as reporting companies, subject to the new requirements, there will likely be additional developments in US anti-money laundering regulations during the Biden administration.

EXCHANGE LISTING

Listing

29 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 the 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 of 1940, as amended, private equity funds do not typically list on a securities exchange in the United States. The applicable listing requirements would be established by the relevant securities exchange.

Restriction on transfers of interest

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

Private equity funds do not typically list on any US exchange. However, if listed, the ability of such a fund to restrict 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

Legal and regulatory restrictions

31 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, unrelated business taxable income (UBTI) for US tax-exempt investors or income that is effectively connected income (ECI) with the conduct of a US trade or business, 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.

In addition, in general, if benefit plan investors hold 25 per cent or more of the 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 the Employee Retirement Income Security Act of 1974 (ERISA) and prohibited transaction rules under Title I of ERISA and section 4975 of the Internal Revenue Code of 1986, need to structure its investments in a manner to ensure that the private equity fund will qualify as a venture capital operating company (VCOC) or a real estate operating company 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.

Compensation and profit-sharing

32 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, the Internal Revenue Code of 1986 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 US Investment Advisers Act of 1940.

UPDATE AND TRENDS

Key developments of the past year

33 What are the most significant recent trends and developments relating to private equity funds in your jurisdiction? What impact do you expect such trends and developments will have on global private equity fundraising and on private equity funds generally?

Global private equity fundraising reached an all-time high in 2021, as funds across buyouts, venture capital, growth equity, secondaries, and other strategies gathered US$733 billion (all statistics in this section provided by Private Equity International). This represents an increase of approximately 27 per cent over 2020, during which US$535 billion was raised in the midst of the economic downturn and other challenges caused by the covid-19 pandemic. Moreover, the number of funds closed in 2021 rose slightly relative to 2020, marking the first increase in such numbers since 2018; 1,384 funds held a final close by the end of December 2021, compared to 1,313 funds in 2020.

Consistent with 2019 and 2020, capital was largely concentrated in mega-funds (ie, funds raising approximately US$5 billion or more) of recognised, top-performing sponsors. This concentration demonstrates 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, consolidate manager relationships and invest with sponsors with whom they had prior relationships (particularly in light of difficulties in meeting new sponsors in person during the pandemic). Specifically, the 10 largest funds that reached a final close in 2021 together raised close to US$150 billion, which represents 20 per cent of total capital raised during 2021. This indicates a slight decrease in consolidation from 2020, where the 10 largest funds that reached a final close in 2020 raised approximately a quarter of total 2020 capital raised. Additionally, the average fund size for 2021 was the largest on record, at US$530 million. This represents an increase of US$63 million over 2020 and almost a 50 per cent increase over 2017.

Regarding the distribution of capital across different types of private equity funds, buyout funds accounted for a fifth by number of the 965 funds that closed from January to September of 2021, and almost 50 per cent of the capital raised during such period (a slight decline from 51 per cent in 2020). Growth funds accounted for the second-largest sector by the amount of capital raised during such period; this strategy raised US$105 billion through the third quarter of 2021, more than doubling the full-year growth fund capital total for 2020. Venture capital funds constituted 47 per cent of the total 2021 fund count, and 16 per cent of the amount of capital raised through the third quarter of 2021 (an increase from 2020). Conversely, secondaries fundraising declined this year through the third quarter of 2021. US$47 billion was closed in secondaries funds over this period, compared to a full-year total of US$82 billion in 2020, and secondaries funds represented 7 per cent compared to 2020's 14 per cent of total capital raised.

Geographically, the fundraising rebound in 2021 was particularly evident in North America-focused funds. The amount of capital raised by North America focused funds doubled year-on-year (from the third quarter of 2020 to the third quarter of 2021) to US$240.9 billion. Comparatively, the percentage of total capital raised by Europe-focused funds decreased to 8 per cent from approximately 12 per cent in 2020. Additionally, as of the third quarter of 2021, the capital raised by funds focused on multiple regions grew 32 per cent from the equivalent period last year.

It is expected that overall fundraising levels will keep pace in the near term, particularly as many fund managers return to the market quickly. A record 3,395 funds in the global market are targeting US$952 billion. Further, the top 10 funds in the global market are looking to raise almost US$180 billion, and at least 15 funds are targeting US$10 billion.

Many investors are also placing a premium on managers with established track records that have navigated a number of past economic cycles. As larger institutional investors will continue to consolidate their relationships with experienced 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, continuation funds, early-closer incentives, umbrella funds, anchor investments, core funds, growth equity funds, impact funds, GP minority stakes investing, secondaries 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 accommodate investors by either lowering fees, expanding co-investment opportunities, focusing on unique investment opportunities or exploring other alternative strategies. In addition, in light of the strong, less volatile performance by private equity funds over recent periods relative to the public markets, institutional investors may increasingly shift allocations from the public markets to private equity. Moreover, it is anticipated that private equity fundraising will continue to focus on established, dominant markets in North America and Europe. Finally, it is also expected that the US Securities and Exchange Commission will continue to focus on transparency (eg, full and fair pre-commitment disclosure and informed 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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TRANSACTION FORMALITIES, RULES AND PRACTICAL CONSIDERATIONS

Types of private equity transactions

1 What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

By 'private equity transaction', we mean an acquisition or disposal whether the buyer or the seller is owned and controlled by a private equity fund.

Most private equity acquisitions are governed by a private sale and purchase agreement, pursuant to which the buyer acquires the holding company of the group. Asset sales are less common: typically, a pre-sale reorganisation would be carried out to ensure all the assets of the target business are housed in a single corporate structure.

Public-to-private transactions can be effected by a bidder making an offer for the listed company (usually under the City Code on Takeovers and Mergers (the Code), which applies to a UK target whose securities are admitted to trading on a regulated market (eg, the London Stock Exchange) or a multilateral trading facility in the United Kingdom (eg, AIM)). An alternative very commonly used in the United Kingdom is a scheme of arrangement, which is a statutory procedure under the Companies Act 2006 (CA 2006) whereby a company can make an arrangement with its members. As a scheme is proposed by the target, in practice it is only possible for a recommended transaction.

Private equity funds often comprise multiple parallel partnerships that together constitute the fund. The fund making the acquisition will typically set up a special purpose vehicle as the buyer, and that is the entity that contracts with the seller.

Corporate governance rules

2 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?

As well as the CA 2006, public companies in the United Kingdom may be subject to various rules and requirements regarding governance and disclosure, including under:

- the Listing Rules;
- the Disclosure Guidance and Prospectus Rules;
- the AIM Rules;
- the Code; and
- the Corporate Governance Code.

These rules and regulations generally cease to apply when a company is delisted or its shares cease trading on the relevant exchange but will apply again if the private equity purchaser later exits by way of an initial public offering.

The corporate governance requirements applicable to a private company are much less onerous. CA 2006 stipulates requirements for annual reporting and certain other disclosure requirements. Private equity funds that are members of the British Venture Capital Association are subject to the Walker Guidelines, which include recommendations (on a comply-or-explain basis) as to governance and enhanced disclosure with respect to certain UK portfolio companies of sufficient size in the United Kingdom. In addition, the Alternative Investment Fund Management Regulations (AIFMD) require a UK alternative investment fund manager (AIFM) to make certain disclosures, including with respect to the acquisition of controlling stakes and its intentions as to UK portfolio companies' future business and the likely repercussions on employment. AIFMD also restricts asset-stripping by imposing additional requirements in the event that a distribution is made by a portfolio company during the two-year period following the acquisition of control by a UK AIFM.

Issues facing public company boards

3 What are some of the issues facing boards of directors of public companies considering entering into a going-private or other 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?

All directors of English companies are subject to statutory duties, including the duty to act in good faith to promote the success of the company for the benefit of its members as a whole. They must also:

- act within their powers;
- exercise independent judgement;
- exercise reasonable care;
- skill and diligence;
- avoid conflicts of interest; and
- declare any interests in proposed transactions.

These duties are owed to the company and not (other than in exceptional circumstances) to shareholders.

The Code includes a number of General Principles that apply in the case of public-to-private transactions, including that:

- target shareholders must be treated equally;
- target shareholders must be given sufficient time and information to enable them to reach a properly informed decision about the bid;
- the target board must act in the interests of the company as a whole and not deny target shareholders the opportunity to decide on the merits of the bid;

- false markets must be not be created;
- a bidder must only announce a bid after ensuring it can fulfil any cash consideration and taking all reasonable measures to secure the implementation of any other type of consideration; and
- a target must not be hindered in the conduct of its affairs for longer than is reasonable by a takeover bid.

The Code also requires that target boards obtain competent independent advice as to whether the financial terms of any offer are fair and reasonable.

Under the Code, a director of the target will normally be regarded as having a conflict of interest where it is intended that he or she should have any continuing role (whether in an executive or non-executive capacity) in either the bidder or target post-acquisition. In any event, there is likely to be a conflict between the duties a director owes to the target and those owed to the bidder. There may also be a conflict of interest in other circumstances; for example, if a director has been appointed as a representative by a target shareholder that makes an offer for the target or wants to roll over into the bidder structure.

Directors of the target should disclose full details of a potential conflict to the board of the target as soon as they are aware of it. A committee will need to be formed of all of the directors of the target who will not have a continuing role post-acquisition, which will be responsible for the target's response to the offer and will decide, after taking independent advice, whether the proposal should be recommended to shareholders.

All directors are responsible for ensuring compliance with the Code, and the Panel on Takeovers and Mergers (the Panel) can take enforcement action against companies and directors that do not do so.

Disclosure issues

4 | Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The General Principles in the Code aim to ensure a high degree of transparency for target shareholders and the market generally, but apply to all take-private transactions, not just those involving private equity sponsors.

Under the Code, a potential bidder for a UK-listed target may be required to make an announcement confirming its interest in making an offer if there is rumour or speculation or an untoward movement in the target's share price. A potential bidder cannot restrict the target from making an announcement about a possible offer. The Code also requires:

- disclosure of certain interests and dealings in target shares following the commencement of an 'offer period'; and
- disclosure of certain information about the offer and the bidder in the offer or scheme document.

Under the disclosure rules for UK-listed companies, a person must notify the issuer and the Financial Conduct Authority (FCA) as regulator of the percentage of voting rights he or she holds as shareholder (directly or indirectly) if the percentage of those voting rights reaches, exceeds or falls below 3 per cent, and each 1 per cent threshold above the 3 per cent threshold. For non-UK issuers, the thresholds are 5, 10, 15, 20, 25, 30, 50 and 75 per cent.

These disclosure requirements do not apply to private companies. However, there is a requirement to disclose (on both private and public registers) 'people with significant control' over UK companies (broadly speaking, with an interest of 25 per cent or more or satisfying other indicia of control). The rules are complex, especially when applied to private equity fund structures. In addition, under AIFMD, a UK AIFM must notify the FCA if it acquires control (meaning more than 50 per cent of the voting rights of a non-listed company or 30 per cent or more of the voting rights of a listed company) of a UK company.

Timing considerations

5 | What are the timing considerations for negotiating and completing a going-private or other private equity transaction?

The Code includes requirements relating to the timetable for a public-to-private transaction. For example, if a possible offer for a target is announced, the Code automatically imposes a 'put-up-or-shut-up' deadline of 28 days, by which time the potential bidder must either announce a fully diligenced, fully financed 'firm intention' to make an offer or down tools. The Panel on Takeovers and Mergers (Panel) may grant an extension to the put-up-or-shut-up deadline, typically only with the agreement of the target board. The Code also prescribes deadlines for certain milestones in a takeover offer process, including the publication of an offer or scheme document and satisfaction of offer conditions.

Generally speaking, the acquisition and sale of private limited companies is not regulated in the United Kingdom, so the parties have a great deal of flexibility as to the timing and conduct of the process, subject to any mandatory antitrust or other regulatory clearances that may be required prior to completion.

Dissenting shareholders' rights

6 | What rights do shareholders of a target have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

As a matter of English law, a shareholder's ability to block a transaction generally depends on the size of its shareholding.

In the case of a takeover offer of a public company, the bidder can set the acceptance threshold at any level that is more than 50 per cent. A bidder for a UK company has a legal right to buy out the minority – the 'squeeze-out right' – which is triggered on satisfaction of a dual test: a bidder needs to have acquired, or to have unconditionally contracted to acquire, both 90 per cent of the shares to which the offer relates and 90 per cent of the voting rights in the company to which the offer relates.

One of the principal advantages of a scheme of arrangement is that, once the scheme has been approved by 75 per cent of each class of shareholder to which the scheme relates and a majority in number of shareholders and is approved by the court, the bidder can acquire 100 per cent of the shares to which the scheme relates. Assuming the shareholder meetings are convened and held properly, other technical requirements are fulfilled and the target shareholders are provided with sufficient information on the scheme, the court would only be expected to decline to sanction the scheme if it considered that the shareholders who attended the meeting did not fairly represent all the holders of the shares that are subject to the scheme (eg, if the vote were not genuine or if it were procured by misrepresentation, bribery, bullying or with a view to advancing other external interests). Although the court must be satisfied that an intelligent and honest person, being a member of the voting class and acting in respect of its own interest, might reasonably approve the scheme, it will generally take the view that shareholders are the best judges of their own commercial interests.

Disputes during a bid process are generally resolved by the Panel Executive and, if necessary, the Hearings Committee, which hears appeals against decisions by the Panel Executive.

Purchase agreements

7 | What notable purchase agreement provisions are specific to private equity transactions?

In the United Kingdom, in private sale and purchase agreements, locked box mechanisms are generally favoured, particularly by private equity sellers. This structure involves fixing a value as at the locked box date, based on the balance sheet as at the locked box date. The seller covenants to procure that the target does not pay any value to the seller from that point. If there is any such value leakage, the seller must repay it to the buyer by way of pound-for-pound indemnity.

Where the acquisition is of a business that is being carved out from a larger business and does not have its own stand-alone balance sheet or audited accounts, it is more likely that completion accounts will be used as the consideration mechanism. However, this is rare for a private equity seller that is selling an entire business.

Private equity buyers will expect customary business warranties (in addition to title and capacity) from sellers, except private equity sellers. Management who hold shares in the target normally provide business warranties on a secondary buyout. The cap on liability for breaches of these warranties is generally low, limited to a percentage of the net returns to the manager shareholders. As such, their function is more to elicit disclosure than to allocate risk between buyers and sellers.

Participation of target company management

8 | 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 acquirer should discuss management participation following the completion of a going-private transaction?

Equity incentivisation of the management team is a fundamental principle of alignment on UK private equity transactions. Private equity acquisitions are typically funded by a combination of external debt funding and preferred return instruments (either preference shares or shareholder loans) with a very small portion of the equity funding funded through the subscription monies for the ordinary shares. All the upside from the investment (beyond the preferred return) flows through to the ordinary shares, for which the management team normally subscribes, and this investment is known as 'sweet equity'. Sweet equity is typically subject to restrictions on transfer, time-based vesting (usually over a four- to five-year period) and leaver provisions that allow for the repurchase of equity from managers who leave the employment of the group, with the price determined by the circumstances in which they become a leaver.

In the case of a public-to-private transaction, the Code includes specific requirements that apply if it is intended that the target's management team will retain an interest in the business or that the target's management team will receive another form of incentivisation. These include obligations to disclose details of the incentivisation arrangements, obtain a fairness opinion from the target company's independent adviser, obtain the approval of target shareholders and occasionally obtain the Panel's consent

These obligations apply where the bidder has entered into, or reached an advanced stage of discussions on proposals to enter into, any such arrangements. As a result, bidders usually put incentives in place after the closing of the transaction.

Tax issues

9 | 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?

On the acquisition of a UK incorporated company, stamp duty will normally be payable at a rate of 0.5 per cent of the consideration paid for the shares acquired. Complex rules exist for determining the stamp duty payable where some or all of the consideration is deferred or contingent. Care will need to be taken where the acquirer assumes debt of the UK target or agrees to ensure outstanding debt is repaid by the UK target to avoid increasing the amount of stamp duty payable. Transaction costs are unlikely to be tax-deductible, but should form part of the capital gains tax base cost of the shares acquired, thereby reducing the capital gain upon exit. Value added tax will also generally be payable in respect of transaction costs, although in very limited cases this may be recoverable.

Given the importance of debt financing in private equity structures, detailed analysis will be required to ensure that the tax-deductibility of interest expense is optimised. In principle, interest expense is deductible, subject to an interest limitation on the group's net interest expense (usually 30 per cent of the taxable earnings before interest, taxes, depreciation, and amortisation of the borrower group). Additional limitations and transfer pricing restrictions can apply in the context of related party debt (eg, shareholder loans) or profit-participating loans. If, as is likely, the acquiring company and the target form a UK tax group, deductible interest expense of the acquirer may be offset against the UK taxable profits of the target group. Where hybrid entities (which are opaque in one jurisdiction but transparent in another) or hybrid instruments (which are treated as debt in one jurisdiction but equity in another) are involved, the UK anti-hybrids legislation can apply to counteract any tax mismatches. Withholding tax will need to be deducted from interest payments on debt that has a term of one year or more unless an exemption applies. Dividends on ordinary or preference shares are neither tax deductible nor subject to withholding tax.

In some cases, private equity funds plan to extract value from the target prior to an exit, in which case it will also be necessary to analyse how distributions from the target business through the holding structure to the funds can be made on a tax-efficient basis. Dividends received by UK companies should generally benefit from an exemption from corporation tax, and there is no withholding tax on dividends paid by UK companies. The likely structure of an exit should also be taken into account when designing the acquisition structure. Where the exit is by way of a sale by a UK holding company, relief from UK tax on chargeable gains may be available under the United Kingdom's substantial shareholding exemption, provided that certain conditions are met (in particular, that the group being disposed of is a trading group). Except where the group is invested more than 75 per cent in UK land, the disposal by a non-UK resident company of shares in the UK holding company of a UK group will not normally be subject to UK capital gains tax.

Where a management equity plan is to be introduced, the tax treatment of UK members of the management team will need to be considered. Complex tax rules apply to shares that are acquired by way of employment and are subject to forfeiture and other restrictions. The acquisition, vesting, lifting of restrictions and (or) disposal of such shares can trigger employment taxes if less than unrestricted market value (UMV) is paid for the shares. It is therefore typical to ensure that management acquires their securities for no less than UMV (with a valuation often being carried out to support the price paid) or, alternatively, management can elect to pay tax on the difference between UMV and the price paid. The effect of this is that any gain on a future disposal of the shares will be taxed at capital gains tax rates. Where loans are advanced to UK managers to fund their investment, an income tax charge will apply unless interest is paid at a rate at least equal to the HMRC official rate of interest or the loan is for a de minimis amount. If management intend to roll their existing investment in the target into shares in the acquisition group, that will need to be structured on a tax-neutral basis.

Transactions structured as share acquisitions cannot be classified as asset acquisitions for UK tax purposes.

While this section focuses on the taxation of the underlying UK investments (rather than the holding structures) of private equity funds, it is noteworthy that the UK government has published draft legislation designed to provide significant tax breaks for qualifying asset holding companies held by qualifying funds and certain other investors. This development will be of interest to private equity funds that wish to hold their underlying investments through a UK holding company. If the draft legislation is enacted in its current form, qualifying UK asset holding companies would benefit from a broad range of tax reliefs; for example:

- an exemption for capital gains on the disposal of investments (other than investments in UK land-rich companies);
- an exemption from UK withholding tax on interest;
- the ability to deduct profit participating interest; and
- the ability to repatriate gains by way of a share buyback without jeopardising capital gains tax treatment for investors.

The tax regimes of jurisdictions other than the United Kingdom should be considered as well, because a private equity fund will typically have investors around the globe and may make investments into the United Kingdom through non-UK entities.

DEBT FINANCING

Debt financing structures

10 What types of debt financing are typically used to fund going-private or other 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 terms of the target's existing debt may require prepayment on a change of control and, even if not, such terms may not meet the buyer's needs going forward or provide the operational flexibility to enable the buyer to implement its business plan. It is therefore usual that existing target debt is refinanced in full as part of the transaction.

Senior debt is the highest-ranking layer of debt and is not subordinated to the other debt instruments in the structure. It usually comprises one or more term loan facilities and a revolving credit facility provided under a senior facilities agreement, and often with a variety of amortising and bullet repayment profiles. Private equity houses have increasingly preferred a 'term loan B', which has a bullet repayment profile, to the 'term loan A', which is typically amortising. The security package for senior debt is first ranking and includes security at the level of the buyer entity plus, following completion of the acquisition, a wider security package from the target group based on agreed security principles. The senior facilities agreement will include positive and negative covenants, including financial covenants, which will be based upon the buyer's business plan for the target. In many cases, private equity sponsors will either obtain cov-lite financing (where there is a springing leverage financial covenant, which is only tested if the revolving credit facility is drawn by more than an agreed percentage) or cov-loose financing (where the financial covenant is typically limited to a leverage-based covenant).

Senior debt can be supplemented with second lien debt (which ranks pari passu with the senior debt other than with respect to the proceeds of security enforcement where it is second-ranking and consequently has a higher margin than the senior debt), mezzanine facilities (which are subordinated to the senior debt and secured on a second-ranking basis with a higher margin still, often partly comprising payment-in-kind (PIK) interest or warrants) and (or) PIK facilities (which are structurally subordinated to the senior and other debt within the banking group and with a higher margin that is paid in kind and added to the principal amount of the debt to be repaid). Compared to senior facilities, covenant baskets are generally set wider and financial covenants are set with more headroom (or there is no financial covenant).

Another financing option is to issue high-yield bonds. These can be secured or unsecured, senior or junior ranking and can be issued alongside senior debt or on a stand-alone basis alongside (and often subordinated to) a revolving credit facility if required to provide working capital credit facilities for the target. High-yield bonds are publicly traded debt instruments that tend to be issued with fixed rates and with an obligation to pay a make-whole amount or prepayment premium upon early redemption. High-yield bonds will also have incurrence-based covenants only. As the timeline for issuing high-yield bonds is longer than for putting in place a facilities agreement, borrowers often put in place a bridge facility, which is used to fund the acquisition with the high-yield bonds being issued to refinance that debt after completion.

In more recent times, there has been a rise in financings provided by specialist credit funds or direct lenders. When provided by a credit fund rather than a syndicate of banks, the debt is often structured as a unitranche facility, which is a single-bullet repayment tranche facility combining the risk of senior and junior debt at a blended interest rate. Unlike traditional senior debt, prepayment of unitranche debt will generally trigger an obligation to pay a make-whole amount or prepayment premium. Bank lenders will often make revolving credit facilities available to the borrowers of term debt provided by specialist credit funds. Such revolving credit facilities will generally be provided by bank lenders on a super-senior basis to the term debt with respect to the proceeds of security enforcement.

English law restricts the provision of financial assistance by a public company for the purchase of its own shares or those in its private holding company or by a private company for the purchase of shares in its public holding company. Typically, this restriction is only relevant in the context of a public-to-private transaction, where it is necessary to reregister the target company as a private company before the target group grants guarantees and security in support of the bidder's financing.

Debt and equity financing provisions

11 What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements for private equity transactions? What other documents typically set out the financing arrangements?

The City Code on Takeovers and Mergers (the Code) requires a bidder to obtain a 'cash confirmation' from a financial adviser confirming the availability of financing on a 'certain funds' basis until the latest possible date on which consideration is payable under the offer or scheme.

Consequently, debt and equity financing must be very advanced when the firm intention announcement is made. The documentation will typically include an equity commitment letter from the private equity fund and binding financing commitments in the form of full facility documentation or an interim facility agreement that is capable of being drawn, plus a commitment letter including a term sheet for the full facility documentation. The conditions to drawing any debt facilities put in place to finance the acquisition of a UK public company will be very limited (including only matters within the control of the bidder or matters such as the absence of insolvency or illegality). In particular, there can be no conditions relating to the target group (in particular, there is no scope for a ratings requirement, minimum earnings before interest, taxes, depreciation, amortisation condition or other matters relating to business performance). Under the Code, all documentation relating to the financing of a UK public-to-private transaction must be made available on the website of the bidder or the target.

Fraudulent conveyance and other bankruptcy issues

12 Do private equity transactions involving debt financing raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

Under English insolvency law, certain transactions may be liable to be set aside if entered into within a specified period (ranging from 12 months to two years, depending on the transaction) prior to the onset of insolvency. These include:

- a transaction at an undervalue;
- a preference (a company intentionally putting one creditor in a better position than another);
- an 'extortionate' credit transaction;
- the granting of an invalid floating charge; and
- a transaction defrauding creditors.

In the case of a private equity portfolio company, the granting of guarantees or security by the target group for the purpose of the bidder's financing, or the repayment of shareholder debt while third-party debt remains outstanding, may be subject to scrutiny in the event of insolvency.

SHAREHOLDERS' AGREEMENTS

Shareholders' agreements and shareholder rights

13 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 or other equity co-investors? Are there any statutory or other legal protections for minority shareholders?

Shareholders' agreements with other equity co-investors vary greatly and the governance is driven mainly by the size of the stake held.

A minority co-investor typically enjoys minority protection, information rights and may have a board seat or right to appoint an observer to the board. For such larger equity investments, the co-investor will take part in due diligence and have some oversight of the transaction documents. Most shareholder agreements include drag-along rights, whereby the private equity fund majority shareholder can force the minority shareholders to sell to a buyer of a majority of the issued shares on the same price and terms. The quid pro quo for a drag right is a right to tag-along to the sale by the majority shareholder. This means that if the private equity majority shareholder sells a majority stake to a third-party buyer, the minority shareholders are entitled to sell to the same buyer on the same terms.

Where private equity funds form a consortium to make a very large acquisition, stake size and governance arrangements are relatively equal. Each private equity fund will have significant governance over the underlying portfolio company and influence on exit strategy, often without drag-along rights but usually with tag-along rights and also a right of first offer requiring each investor to allow the others to offer to acquire its equity before it is sold to a third party.

As a matter of English company law, shareholders holding 25 per cent or more of the ordinary equity of a company have the ability to block certain company resolutions, such as amendments to the articles of association and certain corporate actions. However, it is more common for the parameters for such decision-making to be negotiated upfront and governed contractually.

ACQUISITION AND EXIT

Acquisitions of controlling stakes

14 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 private equity transactions involving unlisted companies where the business is regulated, the regulator of such business may need to approve a change of control, or at least be notified of it.

UK merger control is governed by the Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013. The Competition and Markets Authority (CMA) is the principal regulatory body tasked with ensuring that the markets are competitive, and examines mergers and acquisitions. The United Kingdom has a voluntary regime, which means there is no obligation to refer deals to the CMA. However, if the transaction meets the relevant thresholds and the parties do not notify, the CMA may launch its own investigation and has extensive powers to impose stringent interim hold-separate orders as well as a range of final remedies, including ultimately to unwind the transaction. Therefore, where material substantive competition issues arise on an acquisition meeting the relevant jurisdictional thresholds, most private equity buyers will require CMA approval as a condition precedent to closing.

In addition, the UK government has recently consulted on a host of reforms to national competition law rules, including the thresholds of its merger control regime. While that regime will remain voluntary, the proposed introduction of a new jurisdictional basis – that would be satisfied where at least one party to a transaction has £100 million UK turnover and at least a 25 per cent UK share of supply (without any need for a target increment) – represents a major potential expansion of the current regime. In particular, it is likely to bring into scope a larger proportion of transactions backed by private equity and other financial sponsors, given that all their existing controlled portfolio companies would be captured. This change, if made, would continue the recent more active and aggressive approach of the CMA to mergers and acquisitions activity in the United Kingdom.

In addition to the merger control regime, a new national security regime was introduced in the United Kingdom in January 2022.

There is a mandatory offer regime under the City Code on Takeovers and Mergers. Where a person is interested in shares carrying 30 per cent or more of the voting rights, that person must make a mandatory offer in cash (or including a cash alternative) at no less than the highest price paid by that person during the 12 months prior to the announcement of the offer.

Exit strategies

15 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 acquirer?

Normally, the private equity fund has full flexibility to achieve its exit. Private equity funds are typically closed-end funds and therefore the usual investment horizon is between two and seven years, to fit with the life of the fund as well as completion of business plan milestones for the portfolio company's business and exit market conditions.

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The most common form of exit is by way of an auction sale to strategic trade buyers or other institutional investors (including private equity funds). IPOs are common where the IPO market conditions are good for the relevant sector. Often a private equity fund will run a dual-track exit process, where the company undergoes both an auction sale process and an IPO exit process and ultimately the sellers proceed with whichever option achieves the best valuation (balanced with execution risk).

Private equity sellers will always seek to minimise their liability following the sale of a portfolio business, because they aim to return all proceeds to investors as soon as possible, to maximise their investors' return. Holding back funds to satisfy contingent liabilities following the sale of a portfolio company would be a drag on the returns and therefore affect the fund's performance.

The obligations assumed by a private equity seller under the terms of a sale and purchase agreement are normally restricted to matters that the private equity seller can be sure will not give rise to any liability. These typically include the obligation to transfer its shares (or other securities) free from encumbrance, warranties as to its ownership of the shares (or other securities) and capacity to enter into the agreement, a leakage covenant, an undertaking to exercise its rights to operate the target business in the ordinary course and not to undertake certain material matters without the buyer's consent, and confidentiality obligations. It is unusual for a private equity seller to provide specific indemnities or tax covenants. A private equity seller will seek to limit its total liability to the amount of consideration received in respect of the shares and to a maximum period of 18 or 24 months.

Private equity sellers will not normally give restrictive covenants, such as a non-compete undertaking and an undertaking not to solicit senior employees, because it is problematic to limit the business of a private equity fund that is to buy and sell other companies, frequently in sectors in which it has experience. They will occasionally agree not to solicit key employees for a restricted period, provided that such an obligation extends only to the actual fund that owns the selling entities, and not to related funds.

It is increasingly common for warranty and indemnity insurance to be procured on transactions involving private equity sellers, to increase the protection provided by business warranties to 10 or 20 per cent of the total consideration. It is unusual to insure known problems (eg, the outcome of a particular investigation or piece of litigation), as the cost is prohibitive.

Portfolio company IPOs

16 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?

Relationship agreements are required to be put in place between the private equity shareholder and the listed company where the shareholder will retain 30 per cent or more of the company following an IPO. The private equity shareholder will typically retain the right to appoint representatives to the board for so long as its shareholding remains above a specified level (eg, two representatives at or above 20 per cent, falling to one below 20 per cent and none below 10 per cent). Owing to UK Listing Rules requirements that listed companies operate independently of their controlling shareholders, the appointment of such directors is subject to the approval of independent shareholders as well as of the shareholders as a whole. Listing Rules requirements also mean that private equity shareholders do not retain contractual veto rights over the operation of the target business.

Private equity shareholders are typically restricted from selling their shares for six months following an IPO, with management sellers locked up for a longer period, usually 12 months. Following the expiry of the lock-up, private equity shareholders typically sell down their stakes through block trades arranged by one or more banks, usually in the form of an accelerated bookbuild conducted over the course of a few hours after the markets close. Because all shares are listed as part of the IPO, the required documentation is limited and there is no need for a prospectus or other registration document.

Target companies and industries

17 What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in industry focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Technology, media and telecoms and business services were key areas of focus for private equity investors in 2021. Online and healthcare businesses remained attractive. The hospitality sector continued to struggle, with deal activity being focused on restructurings.

SPECIAL ISSUES

Cross-border transactions

18 What are the issues unique to structuring and financing a cross-border going-private or other private equity transaction?

A recent major legal development for the private equity community was the introduction of a new national security regime. The National Security and Investment Act 2021 (NSIA 2021) came into force on 4 January 2022 and established a new, standalone statutory regime, alongside the government's existing powers of intervention under the Enterprise Act 2002.

Notification to the UK government is now mandatory for a transaction involving an entity undertaking particular activities within any of 17 high-risk sectors of the UK economy if the acquirer would cross the 25, 50, or 75 per cent shareholding or voting-right threshold. There are no de minimis exceptions or financial thresholds applicable to the definition of a qualifying entity, although sector-specific thresholds may apply. In this respect, the scope of NSIA 2021 goes further than many other global foreign direct investment regimes, which generally require a local subsidiary, assets or at least branch office to be triggered. The UK regime can be triggered by employees undertaking research and development activity or sales to UK customers alone, meaning potential filings under NSIA 2021 may be required in the context of global transactions where the target has only a remote UK nexus.

In addition, the government now has the power to call in a transaction (including a transaction where the acquirer is below the 25 per cent threshold but would gain the ability to influence materially the policy of the target entity) in any sector where it reasonably suspects there is a risk to national security. This power is retrospective and applies to all transactions that closed on or after 12 November 2020. The 'material influence' test can capture shareholdings as low as 15 per cent (or in rare cases, even lower than 15 per cent), rights to board representation or even contractual relationships. The same concept is applied broadly under the UK's merger control regime. Parties who consider that their transaction may raise national security concerns may make voluntary notifications to avoid the risk that the transaction is called in retrospectively.

The government anticipates that there will be approximately up to 1,830 transactions notified annually under the new regime (more than the entirety of the European Union in 2020) and that 70 to 95 of those will be called in for a full assessment. This would represent a dramatic increase compared to the total of fewer than 20 transactions

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that have been reviewed on national security grounds since 2003 (when the previous regime began).

This expansion of the regime reflects the wider global trend of jurisdictions introducing or increasing the scope of the foreign investment regime. For private equity investors, a good understanding of the applicable rules and how they could impact potential transactions is crucial to minimise deal risks and potential delays to deal timetables.

Club and group deals

19 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 funds and other partners that form a consortium must agree on a number of matters from the outset to avoid disputes, including:
- whether they are working together exclusively;
- how they will share transaction costs, make decisions about the transaction and share information; and
- how partners may be admitted to, or withdraw or be excluded from, the consortium.

The consortium members must also agree upon their respective equity commitments and ensure that they are aligned on:
- their objectives (both strategic and financial);
- future funding capacity;
- the investment horizon; and
- commercial, financial and legal sensitivities.

It is common for a collaboration or bidding agreement to be entered into that records the basis on which the consortium has been formed. The agreement will often include a term sheet for a shareholders' agreement between the parties that prescribes the governance arrangements for the target business and provisions relating to transfers and exit.

Issues related to certainty of closing

20 What are the key issues that arise between a seller and a private equity acquirer related to certainty of closing? How are these issues typically resolved?

Deal certainty is a fundamental principle of UK mergers and acquisitions transactions, particularly in private equity deals. Typically, only mandatory and suspensory regulatory or antitrust conditions are acceptable (or antitrust clearance from the UK regulator, which is technically voluntary but advisable if there are substantive issues). Material adverse change provisions (entitling a buyer to terminate the transaction) are unusual. Third-party consents are rarely included as a condition.

One of the most hotly negotiated provisions in a sale and purchase agreement is the hell or high water provision, which requires a buyer to take whatever steps are required to be taken – including divestments or the agreement of undertakings – for the transaction to be cleared or approved by a regulatory authority. This provision is therefore typically resisted or significantly watered down by private equity buyers.

Given the focus on deal certainty, termination rights are heavily resisted. The sale and purchase agreement terminates if the limited conditions are not satisfied by a specified long-stop date. If various completion obligations are not complied with at the planned time for completion, then the non-breaching party can usually elect to postpone completion, affording the breaching party a remedy period, but termination is rarely automatic.

Break fees are highly unusual in private equity transactions. On public-to-private transactions, break fees are generally not permitted by the City Code on Takeovers and Mergers.

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UPDATE AND TRENDS

Key developments of the past year

21 Have there been any recent developments or interesting trends relating to private equity transactions in your jurisdiction in the past year?

As the covid-19 pandemic continued through 2021, market participants adjusted to the new normal and there was a boost in activity, with significantly increased private equity transactions (by value and volume) compared with 2020. There continues to be significant interest in listed companies and overall private equity funds still have very significant amounts of dry powder to spend, plus access to inexpensive debt.

TRANSACTIONS

United States

Atif Azher, Fred de Albuquerque, Samuel Watters and Matthew Walls

Simpson Thacher & Bartlett LLP

TRANSACTION FORMALITIES, RULES AND PRACTICAL CONSIDERATIONS

Types of private equity transactions

1 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 often structured as leveraged buyouts (LBOs) in which a portion 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 the company's 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, less commonly, a two-step transaction involving a tender offer followed by a merger. Going-private transactions that are subject to Rule 13e-3 of the US Securities Exchange Act of 1934, as amended (the Exchange Act) generally require significantly greater disclosure than other types of private equity transactions.

Private equity funds typically create one or more legal entities, referred to as special-purpose 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 structuring considerations dictate the type and jurisdiction of organisation of an acquisition vehicle, including, among others, tax concerns, desired governance framework, the number of equity holders, equity holders' (and the private equity sponsor's) exposure to potential liability by use of the applicable special purpose vehicle, general ease of administration and any applicable regulatory requirements.

In addition, 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 type of add-on acquisition 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 the natural growth of the original portfolio company. Add-on acquisitions may be financed through a variety of means, including existing cash on the portfolio company's balance sheet, additional equity financing from the existing private equity fund, new equity financing from one or more new co-investors (that consists of new investors) raised specifically for the acquisition 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 or antitrust scrutiny and potential integration issues following the closing of the transaction.

Corporate governance rules

2 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 (the Sarbanes-Oxley Act), related Securities and Exchange Commission (SEC), stock exchange rules and certain state laws 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, a majority of the target's board of directors, audit committee, nominating or corporate governance committee and compensation committee must meet stringent independence requirements;
- if the target company is headquartered in California, as a result of California passing SB 826, the board of directors must include at least one female director by the end of 2019 and, by the end of 2021, a board of directors with five members must have at least two women and a board of directors with six or more members must have at least three women;
- 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, compliance with foreign corruption and anti-bribery laws 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 the management of a public target to purchase equity of the target or a new entity 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 and the post-IPO lock-up restrictions that often prevent any meaningful sale of the target's stock until, generally, 180 days after the IPO.

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 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.

Issues facing public company boards

3 What are some of the issues facing boards of directors of public companies considering entering into a going-private or other 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 sponsor and target will enter into a confidentiality agreement, which may include additional important restrictive covenants with respect to the sponsor, such as an employee non-solicitation provision and a 'standstill' provision (which 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, 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 the 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.

Disclosure issues

4 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 Exchange Act, 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

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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 becoming delisted on a stock exchange. 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 a private equity sponsor.

Timing considerations

5 What are the timing considerations for negotiating and completing 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 Schedule 13G filing;
- the time necessary for the target company's board or special committee to conduct a market check prior to signing, or if not conducted prior to signing, through the use of a 'go-shop' period post-signing;
- 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 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 and timing 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.

Dissenting shareholders' rights

6 What rights do shareholders of a target 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.

Purchase agreements

7 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, sponsors have 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 guaranteed by the private equity fund. 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.

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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.

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.

Participation of target company management

8 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 acquirer 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 equity holders' 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 and, in some cases, piggyback registration rights.

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 earlier, 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.

Tax issues

9 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. Such pass-through structures may also permit a private equity seller to monetise a step-up in the tax basis of the assets of the target delivered to a potential future buyer or in the case of certain IPO structures. 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 (which may include the use of corporate 'blocker' entities).

Private equity transactions may also 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 Cuts and Jobs Act, 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. The Coronavirus Aid, Relief, and Economic Security Act included a temporary increase to this limitation, among other tax relief provisions. 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). Given the importance of the availability of interest deductions to modelling leveraged acquisitions, understanding the potentially significant limitations imposed by this rule is critical. In addition, careful attention must be paid to the terms of the acquisition debt to ensure that the interest is otherwise 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.

DEBT FINANCING

Debt financing structures

10 What types of debt financing are typically used to fund going-private or other 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 leveraged buyout (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 Securities and Exchange Commission 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.

Debt and equity financing provisions

11 | What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements for private equity transactions? 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 roadshows, 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.

Fraudulent conveyance and other bankruptcy issues

12 | Do private equity transactions involving debt financing 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 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.

SHAREHOLDERS' AGREEMENTS

Shareholders' agreements and shareholder rights

13 | 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 or other equity co-investors? 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 of 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 initial public offering (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 shareholders.

In the United States, 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 equity-holder 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).

ACQUISITION AND EXIT

Acquisitions of controlling stakes

14 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) for the board to feel comfortable that it has satisfied its fiduciary duties to the target company's shareholders. In addition, 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.

Exit strategies

15 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 acquirer?

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 the acquired company to undertake 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.

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.

Portfolio company IPOs

16 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 an 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 to the public. 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. 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 United States. However, 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, including requiring the company to file a shelf registration statement once eligible, 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' shelf takedown off the company's 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.

Target companies and industries

17 What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in industry 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, the 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, healthcare, infrastructure, 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, infrastructure, 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. Further, 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.

SPECIAL ISSUES

Cross-border transactions

18 What are the issues unique to structuring and financing a cross-border going-private or other 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

TRANSACTIONS

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. 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 its investment or effectively exercise pre-emptive rights, implement capital raises or obtain additional financing.

US sponsors offering co-investment opportunities to foreign investors, seeking to sell portfolio companies to non-US buyers or considering other transactions involving investments by foreign parties in US businesses 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. Further, in November 2018, Congress expanded CFIUS's jurisdiction by enacting the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) to include certain non-controlling investments by foreign persons in certain US businesses involved in critical technologies, critical infrastructure, and sensitive personal data of US citizens (collectively defined in the regulations as 'TID US Businesses'), as well as acquisitions of real estate and leaseholds near sensitive US military or other government facilities. 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, but in practice, many parties decide to abandon a transaction if they are unable to negotiate an acceptable mitigation agreement. 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 or a mandatory declaration is necessary under new requirements under FIRRMA, 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. Depending on the nature of the US business, divestiture to an entity with foreign ownership interests may also require other national security regulatory approvals in conjunction with CFIUS reviews, such as from the Federal Communications Commission (with possible referral to the US Team Telecom review process), the Department of Defense's Defense Counterintelligence and Security Agency) with respect to facility security clearances or the Department of State's Directorate of Defense Trade Controls with respect to registrations and licences issued pursuant to the International Traffic in Arms Regulations, among others.

Apart from CFIUS, many countries around the world have also implemented similar national security-focused foreign direct investment (FDI) screening procedures. This has become a particular focus during transaction diligence for US and non-US investors alike as many major global economies have recently introduced or expanded their domestic regimes. For example, the United Kingdom recently commenced a new national security screening process in January 2022 pursuant to the country's National Security and Investment Act 2021, which comes on the heels of several similar initiatives in a number of jurisdictions across the European Union over the past few years. Elsewhere, legislation passed in Australia in 2020 expanded the criteria used to determine whether a transaction must be notified to the country's Foreign Investment Review Board (FIRB) and afforded the government new call-in powers to review transactions that may pose a national security risk. FDI regimes in many countries impose mandatory filing requirements or have the ability to require the parties to submit an application to the relevant ministry – often with disclosure and reporting obligations concerning an investment fund's limited partners or equity investors – and regulators usually have the authority to block or impose conditions with respect to an acquisition or investment. These regimes can apply even when a transaction target, such as a US parent company, maintains foreign subsidiaries, operations, or assets, and so a comprehensive multi-jurisdictional FDI assessment that considers applicable filing requirements on a global basis is often prudent. Mandatory triggers ordinarily involve sensitive industries such as defence, energy, telecommunications, critical infrastructure, healthcare, advanced technologies such as artificial intelligence, financial services, and sensitive personal data, among others. But some can also be triggered merely by the ownership profile of the investor, such as in the case of India's Press Note 3 (2020 Series), which imposes restrictions on investments in Indian entities by parties from neighbouring countries like China, or where certain government investor thresholds are exceeded such as in the case of Australia's FIRB. It is important for parties to assess the FDI regimes that may be implicated by a transaction early in the process to avoid the potential for penalties and intervention by foreign regulators, understand the impact that they may have on the regulatory closing timeline, build in necessary closing conditions to transaction documentation, and engage with regulators when necessary or advisable.

Further, 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.

Club and group deals

19 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 United States, 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.

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 the 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. 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.

Issues related to certainty of closing

20 | What are the key issues that arise between a seller and a private equity acquirer 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.

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).

UPDATE AND TRENDS

Key developments of the past year

21 Have there been any recent developments or interesting trends relating to private equity transactions in your jurisdiction in the past year?

2021 has been a record-breaking year for private equity transactions. The uncertainty and deterioration in market conditions that accompanied the onset of the covid-19 pandemic brought deal flow to a near standstill during early 2020, but a strong rebound during the second half of 2020, with activity levels reaching US$2.2 trillion in global mergers and acquisitions (M&A) deal value during that period, foreshadowed even higher levels of global M&A activity during 2021. Private equity funds raised approximately US$1.2 trillion in capital during 2021, more than doubling amounts raised during 2020, and over 14,500 private equity deals were announced, a year-over-year increase of 56 per cent from the previous year. Portfolio company exits contributed to this increased activity, with exits during 2021 more than doubling in comparison to 2020 levels. Private equity sponsors exited approximately US$958 billion on investments across 2,834 deals, as compared with 1,583 in 2020 (Refinitiv). We expect another active year for private equity exit activity in 2022, as upwards of 70 per cent of companies acquired by sponsors in 2016 are still owned by those sponsors as of year-end 2021 (Pitchbook).

2021 saw a 120 per cent increase in annual volume for secondary transactions from 2020, increasing to US$132 billion across the whole year. Continuation funds accounted for 84 per cent of all general partners-led secondary market volume, nearly doubling their proportion from just two years prior (Jefferies). A continuation fund is a fund raised by a private equity sponsor as a new vehicle to take on the portfolio investments of a current fund nearing the end of its lifespan. This mechanism resets the clock on the investment period, provides liquidity to certain investors and allows more time to take advantage of the assets' future growth potential. This fund serves as an alternative to traditional liquidity paths such as sales to other third parties or an initial public offering (IPO) of the portfolio (Pitchbook). In addition, transactions involving special purpose acquisition companies (SPACs) drove a significant portion of the increase in private equity-backed public listings, particularly during the first half of the year. Across the year in total, 355 SPACs raised US$598.8 billion, in comparison to US$83.1 billion raised by 255 SPACs during 2020 (SPACInsider).

Despite some concern of economic slowdown in the United States caused by elevated inflation levels, anticipated increases to interest rates, supply-chain challenges and continued covid-19 variants, private equity expectations for 2022 nonetheless remain strong. Private equity firms are entering 2022 with record levels of dry powder, reportedly over US$2.3 trillion, about 14 per cent higher than year-end 2020 levels (PwC). In addition, nearly 500 SPACs collectively hold over $138 billion in IPO proceeds as dry powder while seeking M&A targets for de-SPAC transactions in 2022 (PwC). However, given such unprecedented levels of private equity M&A activity in 2021, it is unclear whether 2022 could be another banner year.

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