The Private Equity Review

Fourth Edition

Editor
Stephen L Ritchie

Law Business Research

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EDITOR'S PREFACE

The fourth edition of *The Private Equity Review* comes on the heels of a solid but at times uneven 2014 for private equity. Deal activity and fundraising were strong in regions such as North America and Asia, but were flat to declining in Western Europe. Nevertheless, private equity continues to play an important role in global financial markets, not only in North America and Western Europe, where the industry was born, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. As large global private equity powerhouses extend their reach into new markets, home-grown private equity firms, many of whose principals learned the business working for those industry leaders, have sprung up in many jurisdictions to compete using their local know-how.

As the industry continues to become more geographically diverse, private equity professionals need guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 26 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

While no one can predict exactly how private equity will fare in 2015, it can confidently be said that it will continue to play an important role in the global economy. Private equity by its very nature continually seeks out new, profitable investment opportunities, so its further expansion into growing emerging markets is also inevitable. It remains to be seen how local markets and policymakers respond.

I want to thank everyone who contributed their time and labour to making this fourth edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2015

Chapter 16

UNITED KINGDOM

Mark Mifsud, Lisa Cawley and Jane Scobie[1]

I GENERAL OVERVIEW

In the previous edition, we reported that 2013 seemed to be the year in which the tides of private equity began changing in favour of beleaguered European general partners (GPs)[2] raising funds. This was borne out in 2014 in that such tide strengthened, as funds focusing on Europe raised significantly more capital in 2014 (US$36 billion) than in 2013 (US$15.4 billion), leading to 39 per cent of capital raised in 2014 having a primary focus on Europe, as opposed to 17 per cent capital in 2013.[3]

This increase in focus towards Europe was largely directed toward the UK, Nordic, German and Benelux regions with a survey of 90 institutional investors by Probitas Partners picking the UK as a particular bright spot: institutional interest in the UK region is expected to increase further in 2015, and there is an expectation that it will overtake the current favourite, the Nordic region, as the most attractive area for institutional investors. This interest was reflected in a number of successful oversubscribed UK fundraisings, such as Inflexion, which raised its Inflexion Buyout Fund IV and Inflexion Partnership Capital Fund I within five months, securing £650 million and £400 million respectively,[4] and ECI Partners, which launched with a target fund size of £400 million and closed at the hard cap of £500 million, again within five months.[5]

1 Mark Mifsud, Lisa Cawley and Jane Scobie are partners at Kirkland & Ellis International LLP. The authors would like to thank Prem Mohan for his contribution to this chapter.

2 In this chapter, 'firm', 'manager' and 'GP' are used interchangeably, and could include reference to GPs, advisers, etc.

3 Preqin.

4 www.inflexion.com/press-releases/inflexion-double-fund-success.

5 www.ecipartners.com/news-and-media/post/eci-raises-500m-for-10th-fund.

Thus, although the amounts raised in private equity globally have remained flat in 2014 with approximately US$517 billion in aggregate capital commitments (which was US$10 billion less than the aggregate capital raised in the previous year), Europe and the UK took a larger share of such capital.

The strong flow of distributions received by investors from their private equity holdings in 2014 (an increase of 30 per cent to US$428 billion according to current data) helped to underpin investors' willingness to reinvest in the asset class,[6] and a number of new entrants such as Sovereign Wealth Funds, family offices and investors who had abandoned the asset class during the global financial crisis rejoined the fold in 2014.

It was this flow of money that led to an element of concern as investors experienced some difficulty in 2014 with accessing certain funds or investing on a sufficient scale (or both). This issue demonstrated starkly the bifurcated market of the 'haves' and 'have nots' in 2014, and its critical effect on the industry – in 2014, the number of managers being able to hold a final close was reputed to be at its lowest level since 2010, as investor capital concentrated on a smaller number of GPs and was not being widely distributed in the industry. Thus, 2014 was another tough year for first-time managers, with just 7 per cent of aggregate capital[7] raised by such managers, and a number of such first-time funds involving an anchor or cornerstone investor with preferential terms.

II LEGAL FRAMEWORK FOR FUNDRAISING

i Jurisdiction and legal form

The key drivers in any fund structure are generally those of limited liability, tax transparency and efficiency, ease of use and flexibility. Notwithstanding the wide range of possible structures that could be utilised, a limited partnership structure is the vehicle of choice for most UK fundraisings.[8] As expanded upon further below, the general trend is for the fundraising market to adopt two main strategies in structuring: being located within the UK (thus being subject to the full range of UK tax and regulation, including – for larger firms – the Alternative Investment Fund Managers Directive (AIFMD)), or being located offshore (thereby being outside of the UK's (and EU) VAT, tax and regulatory net).[9]

The former strategy would generally utilise an onshore limited partnership, usually an English limited partnership (although Scottish or other jurisdictions may be used). The latter strategy would generally involve the use of an offshore-domiciled limited partnership – generally Guernsey or Jersey – although the former seems to be the favoured jurisdiction for offshore private equity funds, albeit with increasing competition from Jersey. Other possibilities include Delaware, the Cayman Islands and Bermuda, but these are very much the exception in a UK fundraising, primarily due to time zone and investor familiarity concerns.

6 The 2015 Preqin Global Private Equity Venture Capital Report.

7 Id.

8 Structures aimed at the retail market, such as VCTs, are not considered herein.

9 See Section III, *infra*, for more information.

Some investors have preferences as to the location of the fund (usually due to the regulatory or tax regime that they inhabit), and this may have an impact as to the jurisdiction of the fund or its structure, or both; feeder vehicles or tax 'blockers' may need to be incorporated into the structure to cater for the specific needs of a single investor or a group of investors.

Other fundraisings can take the form of a wide range of onshore and offshore vehicles such as Luxembourg limited partnerships, SICARs, SIFs and French FCPRs or offshore companies, although these structures are aimed at specific markets or at specific types or classes of investor and are not the focus of this chapter.

While each GP will claim to have a set of unique terms relating to its fundraising, there are a number of themes that are common to all, albeit with different formulations and treatment between various funds. While not comprehensive, the main negotiated terms of a private equity fund are as follows.

Target size

The target size of the offering is of relevance to investors as they may wish to impose limits on the size of the fund to ensure that it is not too large for the team to manage, thereby ensuring that they focus on transactions of an appropriate size for their investment strategy. Thus, investors may seek to cap the size of a fund and, conversely, seek to subject their commitments to a size pre-condition (i.e., they would only be bound to invest if the fund reaches a 'viable' size), thereby ensuring that they would not be over allocated to that fund, or that the fund would have to make smaller investments, in size or number.

GP commitment

The size of the personal commitment made by the executives and its form (i.e., whether it is financed personally, by waiver or some other method) is also very pertinent to prospective investors who want to ensure that they have 'skin in the game'.[10] The expected number used to be in the region of 1 per cent of fund commitments; however, due to investor pressure this has been steadily increasing, and its financing made more transparent and more cash-based.[11]

Closing period

This is the period during which more investors can be admitted to the fund. The 'market' position used to be 12 months from the first closing of the fund; however, managers have argued for an increase as a response to the increase in time required to fund raise and deal with investor due diligence, etc. Investors have generally accepted this extended period notwithstanding their concerns that the management team would be distracted from deal sourcing and investment activity by their fundraising efforts.

10 *Private Equity International*, 'LPs push GPs to put more "skin in the game"', 21 February 2012.

11 ILPA Version 2.0, 'General Partner Commitment' states that 'the GP should have a substantial equity interest in the fund and that it should be contributed in cash as opposed to being contributed through various management fees'.

Investment period

This period during the fund's life is reserved for investing. The manager will have full discretion to draw down all the funds available during this period (subject to relevant limitations such as investment policy and borrowing restrictions). Here, the old status quo of a five-year investment period is also being modified. Managers, in an attempt to avoid any risk of failing to invest their funds fully in the allotted period and thereby having to ask for an extension (see earlier), have argued for the ability to extend their investment periods. This has been met with a variety of responses from investors, some of whom were sympathetic provided that the approval mechanisms were satisfactory, and others who were unmoved and wanted to ensure that their commitments were time limited to five years.

Management fee

Often structured as a profit share, it is usual for the management fee to be calculated as a flat percentage of committed capital during the investment period, stepping down to a percentage of drawn-down or invested capital after the end of the investment period or on the raising of a successor fund. Investors are very sensitive regarding the scale of management fees and their impact on returns, and thus there has been some downward pressure and heightened scrutiny by investors.[12]

Investment strategy and limitations

The offering will specify the appropriate investment strategy to be followed by the fund and relevant limitations providing, for example, limits in relation to maximum exposure to any one investment sector, jurisdiction or industry limitations as applicable. The investment strategy and limitations are an essential key part of any fundraising, and investors are focused on ensuring that they understand any risks and to ensure that there is no 'strategy drift'. The growth in importance of certain sovereign wealth funds, state-aided funds or political agencies has resulted in a number of pools of capital (e.g., EU regional aid) that are solely focused on a single jurisdiction or that are prohibited from investing in certain regions, and thus a number of exclusions to the investment policy may be negotiated, or 'side-car' vehicles with a restricted investment mandate for investing alongside the main fund created, in order to cater for these specific investors.

Investment-related fees

The receipt of any transaction fees, break-up fees, directors' fees or monitoring fees is the subject of much debate among investors and managers. Some, or all, of these fees would typically be set off against the management fee so that the investors would receive some or all the benefit thereof, and investors have been pushing strongly, and often successfully, for a full set-off in their favour.[13] These types of fees are also coming under

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12 See ILPA 2.0, 'Management Fee and Expenses', and the *FT* articles 'Investors push for private equity fee cuts', 28 February 2012 and 'Private equity profits called into question', 23 January 2012.

13 ILPA 2.0, 'General Partner Fee Income offsets'.

increasing regulatory scrutiny, notably by the US Securities and Exchange Commission (SEC), which is affecting some major sponsors' readiness to charge such fees and hence the market position more generally.[14]

Preferred return

There is a surprising lack of movement with the preferred return, notwithstanding today's low-interest-rate economic environment. Although some funds have created more bespoke arrangements, they are very much in the minority, and generally investors prefer less creativity in the structuring of the preferred return mechanism.

Carried interest or distribution mechanism

The standard carried interest payable to the manager, its executives, or both in such private equity funds is 20 per cent of the fund profits. There are two main methodologies for calculating such carried interest –the 'fund-as-a-whole' mechanism and the 'deal-by-deal' mechanism. The former method is most common in Europe, while the latter is most common in the US. As the fund-as-a-whole model is the main European model and is deemed to be investor-friendly in comparison with the deal-by-deal method, most investor negotiations are based around mitigating the risk of any overpayment of carried interest (see below).

Escrow or carried interest clawback

These provisions can be rather bespoke, as a number of facts and circumstances are relevant – for example, the distribution mechanism of the fund (see above), the creditworthiness of the carry recipients and the likelihood, in light of the investment strategy, of losses post receipt of carry. The fund-as-a-whole distribution model provides that the carried interest is payable only after investors receive an amount equal to the aggregate drawn capital and the preferred return thereon, thereby exposing the investors to the risk of carry overpayment if subsequent drawdowns are not fully returned. Escrow mechanisms are usually utilised, although as US investors have generally relied on clawback mechanisms, the market position has changed, and thus sometimes one or both structures are used, often in response to the nature of the investors' likely return or drawdown profile and the executives' attitude to risk (i.e., do they prefer escrowing or subjecting themselves to a later clawback risk?)

Reinvestment

The ability for a fund to redraw prior distributions is of great importance to the manager to ensure that the fund manager has access to the full amount of investor commitments for the purpose of making investments, including amounts that may have originally been drawn down for management fees or other expenses, bridging investments, etc. The limited partnership agreement will typically set out the type of distributions that can

14 'A Few Observations in the Private Fund Space', David W Blass, Chief Counsel, Division of Trading and Markets, SEC (5 April 2013): www.sec.gov/News/Speech/Detail/Speech/1365171515178.

be redrawn and for how long. Certain investors such as fund of funds may be unable to redraw from their own investors and thus push back strongly in this regard.

Exclusivity
This regulates what other funds the manager can raise, and when. This provision comes under discussion as management houses contemplate setting up bespoke side funds or managed accounts, or when the manager attempts to diversify into a multi-product asset management platform.

Default provisions
These set out the suite of remedies in relation to investors who default on drawdowns. In light of experiences since the last global financial crisis and threatened and actual defaults, these provisions have become more extensive in scope.

Key man or suspension of investment period
These provisions have received a lot of investor attention over the past couple of years. They protect the investors from a 'key man event' (i.e., if one or more of the key management personnel ceases to be involved in the management of the relevant fund). As expected, the trigger event is heavily negotiated and specific to each fund and sponsor, and thus much time and attention is given to this particular provision in fund documentation. This term is often linked with the exclusivity provisions, as the ability for a team to perform different functions for different funds is often curtailed.

Removal of the GP on a 'fault' or 'no-fault' basis
These provisions, alongside the key man provisions (see above), are 'governance' provisions, which have been developing in fund documentation. The relevant voting thresholds and the implications for management fees and carried interest in the case of any such event are often fiercely negotiated as investors seek to ensure that they are sufficiently protected from a manager that has lost its way.

Most-favoured nation (MFN)
The MFN provision entitles other investors to benefit from rights given by side letter or otherwise to other investors. With the return of fee and carry discounts, preferential co-invest rights and other special deals in this difficult market, there is a renewed focus on the MFN provision. Managers are seeking to limit applicability by size of commitment, legal status, timing of admission, etc., with investors pushing back in this regard.

Other negotiable terms
The high level of competition for investors' capital and the enhanced due diligence referred to above has resulted in increased investor attention and negotiation on a number of key terms (most mentioned above). The main themes behind investors' negotiations have been increased alignment of interest, governance and transparency – indeed, these are the three guiding principles enunciated in the ILPA Private Equity

Principles Version 2.0 published in January 2011[15] – and while they, in their own words, 'should not be applied as a checklist, as each partnership should be considered separately and holistically', they are revealing as to the concerns of the investor community and serve as a useful basis for discussions on terms.

Another theme in this market that is having an impact on terms is that of incentives for first closers or large investors. This is often given in the form of a reduced management fee or other economic incentive, although other incentives can be utilised, such as preferred access to co-investments alongside the fund or other enhanced rights. This is becoming very much a feature for fundraisings in this market, and a substantial number of funds currently in the market are reported to be offering such incentives.[16]

ii Key items for disclosure

The legislative backdrop now set out in the UK Financial Services Act 2012 (FSA) makes it a criminal offence for any person knowingly or recklessly to make a statement, promise or forecast that he or she knows to be misleading, false or deceptive; or dishonestly to conceal any material facts, if he or she does so for the purpose of inducing, or is reckless as to whether it may induce, another person to engage in investment activity.[17]

Furthermore, a misrepresentation can occur under English law when an untrue statement of fact or law is made that induces the other party to enter a contract and suffer a loss. An action for misrepresentation can be brought in respect of a misrepresentation of fact or law. There are three types of misrepresentation: fraudulent misrepresentation, negligent misrepresentation and innocent misrepresentation. If a party is found to have made a misrepresentation that induced another party into entering in a contract, there are various remedies that may be awarded by the courts depending on which type of misrepresentation has been found to have occurred. Generally, the remedies for misrepresentation are rescission or damages according to the form of misrepresentation.

Additionally, it is usual for a UK-domiciled manager to be authorised by the UK financial services regulator, the Financial Conduct Authority (FCA). It would also have to comply with the FCA's rules, including the wide-ranging Principles for Business, which include obligations to pay due regard to the information needs of clients and to communicate information to them in a clear, fair and non-misleading manner, and with legislation and rules implementing the AIFMD.

US securities laws and other legislation relating to disclosure and fiduciary duties, while outside the ambit of this chapter, would also be pertinent, as most UK offerings would be extended to US investors, and thus misstatements, omissions or other misleading content may lead to SEC enforcement, federal or state action or civil action. European jurisdictions typically also impose similar 'anti-fraud' requirements.

15 See http://ilpa.org/principles-version-2-0 for ILPA 2.0.

16 See http://realdeals.eu.com/mega_market/permira-offers-earlybird-discount-; www.efinancialnews.com/story/2011-09-16/permira-earlybird-discount; and www.penews.com/today/index/content/4068927071/restricted.

17 Section 89 of the FSA.

As such, it is important that the manager performs a verification exercise to ensure that the investor has subscribed on the basis of the best available facts, and thereby minimise the risk of damages claims, recession claims or regulatory sanctions should the fund fail to perform as anticipated. As part of this, the manager will review the offering documents and other related promotions to ensure that all facts and circumstances that will be relevant to a potential investor have been adequately disclosed without material omissions, that all statements of fact are accurate, that statements of opinion are reasonable and are honestly held by those to whom they are attributed, and that all inferences that can be drawn from any of those statements are themselves accurate.

As a matter of best practice, this verification process should be performed by the manager before issuance of any promotional documents.

The main key items for disclosure to investors are usually set out in the final form offering memorandum, which would typically set out:

a the investment highlights, providing a detailed discussion of the investment strategy for the fund and the process by which investments will be made;
b the track record of the manager or of the relevant executives comprising the management team;
c the *curriculum vitae* of the key executives and relevant experience;
d a market overview, so as to provide investors with a macro view of the investment therein;
e the summary of key terms (see above);
f legal and tax matters, describing various regulatory and tax considerations in making an investment in the fund;
g risk factors, so as to make the investors aware of the risks inherent in an investment in the fund; and
h a summary of selected investments from the track record of the manager, thereby providing the investors with further data and other experience at a granular level.

iii Solicitation

The most common method of solicitation is by way of an offering memorandum, although this document evolves through a number of stages. It is first conceived as a 'teaser' pitchbook, which is distributed to potential investors to solicit their initial interest or as a follow up to preliminary meetings or due diligence. This is then developed into a draft offering memorandum, which is usually circulated to potential investors, and is the main promotional document that is used for the 'soft or hard-circling' process before concluding discussions and circulating a final form offering memorandum to investors before the fund's first closing. This process would also take into account the relevant AIFMD marketing strategy of the firm (see Section III, *infra*).

In parallel to this process, it is common for the manager to establish a data site (usually electronic) containing further information on the manager, track record, executives, legal documentation and structure of the offering. Certain investors also tend to issue their own document and information requests in the form of a due diligence questionnaire (DDQ), which the manager must complete and return. Indeed, so common has the DDQ approach become that some managers now pre-complete a 'standard' DDQ for inclusion in the data site so as to expedite the due diligence process.

The same considerations as to the accuracy of information provided in the offering memorandum apply to the information provided in the data site or DDQ responses.

Any changes to the terms or other relevant parts of the offering (e.g., track record or revised valuations) that arise as the fundraising progresses are typically communicated to investors by way of an addendum to the offering memorandum.

The manager may also appoint a placement agent who would assist in the preparation of the suite of offering documents and in identifying and soliciting potential investors.

Throughout this process the manager and the placement agent, if applicable, must ensure that they comply with the AIFMD, the relevant marketing regulations of the pertinent jurisdiction of the investor (including the UK), make any required filings and obtain any required authorisation. While not the subject of this chapter, it should be noted that this body of law has been developing and is becoming more extensive (including with various lobbyist and 'pay-to-play' restrictions in the US), and sophisticated placement agents or managers will now generally seek access (via their legal or marketing advisers) to regularly updated global surveys of the marketing or pre-filing and registration rules of each jurisdiction to ensure that the offering complies with local laws and regulations.

III REGULATORY AND TAX DEVELOPMENTS

i Regulatory developments

The implementation of the AIFMD has altered the regulatory framework applicable to the marketing and management of private equity funds in the UK and the rest of the EU. The AIFMD was required to be implemented in EU Member States by July 2013, and provided for a period of transitional relief that expired in July 2014. It now applies to managers under the following two circumstances: non-EU managers who intend to market a fund to investors in the EU; and EU onshore managers who intend to either market a fund to investors in the EU or manage a fund in the EU.

At present (and until at least 2018), non-EU managers may continue to rely on existing private placement regimes in individual EU Member States[18] to market fund interests to institutional investors, subject to complying with certain minimum requirements under the AIFMD. These provisions are a subset of the compliance obligations applicable to fully authorised onshore managers, and include:

a prescriptive requirements detailing the information to be disclosed to investors prior to investment and on an ongoing basis;

b a requirement to produce an annual fund report with certain prescribed content;

c regulatory reporting requirements; and

18 Some jurisdictions (notably Austria, France and Italy) have chosen to either terminate existing private placement regimes following the implementation of the AIFMD, or to impose highly onerous compliance requirements that result in effectively precluding a non-EU manager from marketing a fund using private placement.

d certain portfolio company transparency, disclosure and 'anti-asset stripping' provisions aimed at preventing private equity firms from making distributions from portfolio companies acquired by the fund other than out of profits.

Additionally, regulators in most EU jurisdictions now require non-EU managers to register the fund that they intend to market in their respective jurisdictions ahead of any marketing. The level of detail involved in completing marketing registrations varies by jurisdiction, from straightforward notifications (after which a non-EU manager can commence marketing) to rigorous applications for marketing approval requiring extensive supporting documentation. Processing times are similarly varied, with some regulators permitting non-EU managers to market a fund immediately on the submission of a marketing notification, and others taking three months to vet and approve applications for marketing approval.

The UK has chosen to adopt a relatively straightforward registration procedure under which non-EU managers may commence marketing a fund once a short marketing notification is completed and filed with the UK regulator, the FCA. In carrying on any marketing activities in the UK, non-EU managers are required to continue complying with the UK's pre-AIFMD national marketing rules, the financial promotions regime. Therefore, non-EU managers continue to target only those investors (such as regulated firms and high-net-worth entities) that fall within one or more exemptions to the financial promotion restrictions under UK law.

The AIFMD gives EU Member States the discretion to impose stricter requirements on non-EU managers in addition to the minimum requirements set out above. These stricter, 'gold-plated' requirements may flow from other provisions of the AIFMD (otherwise not applicable to non-EU managers). For instance, non-EU managers intending to market a fund in Denmark or Germany are required to appoint a depositary for that fund, an obligation that otherwise applies only to fully authorised onshore managers (see below). In implementing the AIFMD, the UK has chosen not to apply any 'gold-plated' requirements to non-EU managers.

As a consequence of these new registration requirements, a non-EU manager must consider, for each fund that it proposes to raise in the EU, the point of time at which it will need to register the fund for marketing with a local regulator. This in turn will depend on how local regulators interpret the term 'marketing' under the AIFMD.[19] In the UK, the FCA has taken the view that certain 'soft marketing' activities, such as the circulation of a promotional presentation on the fund or a draft private placement memorandum to UK investors, do not constitute 'marketing' for AIFMD purposes. Consequently, non-EU managers may carry on such activities in the UK ahead of registering the fund with the FCA (on complying with the UK financial promotion regime). Regulators in other EU Member States may adopt a different interpretation of 'marketing', potentially leaving a non-EU manager with a narrower range of permissible 'soft marketing' activities that

19 The AIFMD defines 'marketing' as a direct or indirect offering or placement, at the initiative of the (manager) or on behalf of the (manager) of units or shares of an (alternative investment fund) it manages, to or with investors domiciled or with a registered office in the EEA.

can be undertaken in those jurisdictions before registration. To the extent permitted by a local regulator, soft marketing enables a non-EU manager to gauge whether there is sufficient investor interest in a particular jurisdiction to justify the initial registration and ongoing AIFMD compliance costs for marketing a fund in that jurisdiction.

It is worth noting that the preamble text to the AIFMD clarifies that the requirements under the AIFMD are not intended to apply to situations where an EU investor invests in a fund of its own initiative. This 'reverse solicitation' carve-out is (depending on facts and circumstances) being relied on by non-EU managers who receive indications of interest and requests for additional information from investors in an EU jurisdiction, and who have not otherwise been solicited by the manager.

EU onshore managers whose assets under management exceed certain thresholds (see below) are subject to the AIFMD's full requirements. These requirements include applying for and obtaining permission to manage alternative investment funds from local regulators, and thereafter complying with a wide range of ongoing requirements on matters such as regulatory capital, internal governance, systems and controls, remuneration and, significantly, the appointment of a depositary to perform cash monitoring, safe custody, asset verification and oversight functions in relation to managed funds. In addition, the minimum disclosure and transparency obligations discussed above that apply to non-EU managers also apply to onshore managers. Onshore managers receive an important trade-off for complying with these onerous obligations, in that they benefit from an EU-wide 'passport' under the AIFMD that they can use to market EU funds to EU investors or manage funds across the EU, or both, without registering with local regulators. Despite the passport's intention of giving onshore managers the freedom to market or manage EU funds without complying with local requirements, some national regulators have placed additional requirements on onshore firms using a marketing passport, which currently include appointing a local agent or paying a passporting fee, or both.

Onshore managers who are authorised under the AIFMD are currently not entitled to use a passport to market a non-EU fund in the EU. Rather, onshore managers of such funds are placed on the same footing as non-EU managers in being required to register a non-EU fund for marketing in a particular jurisdiction under national private placement rules.

Onshore managers whose aggregate assets under management fall below the AIFMD's authorisation threshold,[20] are not required to be authorised under the AIFMD, and are only subject to a limited number of requirements under the AIFMD. They are not entitled to benefit from the marketing or management passport under the AIFMD.

The European Securities and Markets Authority (ESMA) may recommend that the benefit of the AIFMD marketing passport be extended to non-EU managers who choose to register with an appropriate EU regulator (their 'Member State of reference') and comply with the AIFMD in full. The extended passport regime may become available

20 Broadly, aggregate assets under management exceeding €500 million for unleveraged funds that do not have redemption rights exercisable during a period of five years from the initial investment in the fund; or €100 million for leveraged funds.

on a voluntary basis to non-EU managers from late 2015 or early 2016. After this time, non-EU managers choosing not to become fully authorised and compliant with the AIFMD may continue to market funds to EU investors on complying with local national private placement registration requirements, as well as the minimum requirements under the AIFMD applicable to them. This voluntary regime is expected to come to an end in late 2018 or early 2019, when it is anticipated that all national private placement regimes in the EU will be terminated, and that it will become mandatory for all non-EU managers to become fully authorised under and compliant with the AIFMD.

ii Tax developments

One of the main fund structuring objectives is to ensure that the investors in the fund suffer no additional taxes as a result of investing through the fund rather than investing directly in the underlying assets. For this reason, private equity funds in the UK are typically established as limited partnerships so that they are viewed as transparent for most UK tax purposes and do not fall into tax at the fund entity level.

On the basis that the fund is treated as transparent, the characterisation of the receipts of the fund as income (e.g., interest or dividends) or capital (e.g., sale proceeds) should be preserved for UK-resident investors (and some other categories of investors – although this is jurisdiction-specific on a case-by-case basis). While this means that withholding tax issues can arise without appropriate planning, it enables investors to secure capital treatment for any carried interest. With a current difference in rates of up to 45 per cent (for income) against up to 28 per cent (for capital), such an objective is important for most UK-resident carried interest holders. For those carried interest holders who are UK-resident but domiciled outside of the UK, there is also the possibility to defer or keep the proceeds outside the purview of the UK tax regime with appropriate structuring.

There are rules in the UK that can treat at least part of a carried interest return as income rather than capital, broadly by treating the interest as an 'employment-related security'; however, these rules may not be relevant if the relevant carried interest holder is not an employee in the group (but is instead, for example, a partner in a limited liability partnership), or if the fund is structured so as to fall within the safe harbour outlined by HM Revenue & Customs (HMRC) and the British Private Equity & Venture Capital Association in a relevant memorandum of understanding.

There have been a number of developments over the past 12 months, generally focusing on arrangements that HMRC see as 'unacceptable' tax planning. In particular, and with effect from 6 April 2014, UK-resident partners in a UK limited liability partnership will be treated for UK tax purposes as employees (rather than partners) if certain conditions relating to capital at risk, variable remuneration or influence are not satisfied; and where fund structures include a mixed partnership (broadly a combination of corporate and individual partners), rules have been introduced enabling profits and excess losses to be reallocated where there is perceived tax avoidance.

Further, draft legislation targeted at 'GP priority profit share streaming' was published in December 2014. If enacted, the effect will be to tax sums arising to investment managers for their services as income tax (and combat those arrangements that had previously structured this fee so as to benefit from capital gains tax rates or to escape tax altogether).

IV OUTLOOK

As mentioned earlier, the shakeout within private equity will continue with a substantial number of fundraisings failing notwithstanding a number of managers being extremely successful with their fundraising efforts. The unsuccessful are being forced into adopting alternative strategies such as deal-by-deal financings, single investor mandates (including managed accounts) or bespoke economic terms. This has increased traffic in secondary partnership interests as investors seek to be released from funds that they perceive are not being supported by the market or also result in recapitalisation and restructuring solutions for more mature funds, as referenced in earlier editions. Such restructurings will become more commonplace as GPs and their investors seek to address issues raised by the market and an inability to raise new capital and deal with 'zombie' funds.

The AIFMD has now been implemented in Europe. This has had serious ramifications for the industry, with some firms choosing to operate outside the AIFMD and the European Union, while others are taking advantage of the marketing passport. The fundraising strategies of a number of private equity firms are still in flux and under development as each firm attempts to ensure that it succeeds in the face of increased tax and regulatory scrutiny.

Chapter 5

CHILE

Andrés C Mena and Francisco Guzmán[1]

I OVERVIEW

Chile continues to offer an attractive business environment. Chile was the first Latin American economy to join the Organisation for Economic Co-operation and Development, and is party to dozens of free trade agreements (including with the United States, the European Union, Mexico, South Korea and Brazil). In terms of competitiveness in Latin America, according to the ranking published by the Latin American Private Equity & Venture Capital Association (LAVCA),[2] Chile has remained the country with the best overall conditions for the private equity industry for nine years in a row. Confirming this, the 2013–2014 Global Competitiveness Report prepared by the World Economic Forum awarded Chile first place in the competitiveness ranking for Latin America. According to Ernst & Young's annual ranking, Chile leads Latin America as the most attractive market for private equity and venture capital.[3] As a result, private equity in Chile has grown significantly: as of the end of 2013, there were approximately 41 investment funds with an estimated amount of investments of US$700 million, and 27 management firms. Eleven of these funds are private equity funds with investments of about US$345.6 million, and 30 funds correspond to venture capital funds with investments of about US$256.8 million.[4]

1 Andrés C Mena is a partner at Kirkland & Ellis LLP and Francisco Guzmán is a senior associate at Carey.
2 2014 Update of the LAVCA Scorecard 2013.
3 Diario Financiero, 12 December 2013.
4 See Chilean Association of Investment Funds Administrators, 'Venture Capital and Private Equity in Chile' (2013–2014).

i Deal activity

The private equity industry has grown aggressively as a result of changes in the statutory corporate, capital markets and tax framework implemented in the last decade. According to the 2014 Update of the LAVCA Scorecard 2013, investors continue to value the overall environment of institutional and legal certainty, the protection of intellectual property rights, the transparency of the judiciary and the protection of minority shareholders' rights. The adoption in 2014 of the international financial reporting standards for all non-publicly traded companies has also helped in maintaining Chile as a regional leader. Standard & Poor's raised Chile's credit rating in 2012 to AA-, leaving Chile with the highest credit rating in Latin America and at the same level as China, Japan, Estonia, South Korea and Taiwan.

However, the private equity industry is in an early stage, which makes it particularly attractive for new investors. Unlike other countries (such as Brazil) the number of sponsors in the market is still limited and new players are attracted by the opportunity for better value.

The bigger players in Chile (i.e., funds with assets over US$100 million, and with a regional and not purely national focus) are managed both by foreign entities (such as Advent or CVC) and by some regional players (such as Linzor Capital Partners or Southern Cross Group). Other key sponsors in the country are Blackstone, Quilvest, Brookfield, KKR and Partners Group. These funds use local feeder funds to raise capital, mainly from institutional investors. Other local players include Aurus, Equitas Capital, InverSur Capital, BTG Pactual, Larraín Vial, Independencia, IM Trust and Moneda Asset Management.

The size of most funds (private equity and venture capital) is between US$15 million and US$50 million.[5] This is in line with the current trend of Latin America, as according to LAVCA, since 2012 the market shifted towards smaller funds and mid-sized deals.[6]

Typically, foreign sponsors enter the country associated with local firms that have a better understanding of the local market.

The aggregate amount of deals increased considerably by volume but also decreased by deal count during 2013 (although no final figures are available for 2014 at the time of writing this chapter, we provide information on the Chilean market during 2014 in Section III, *infra*). There were a total of 12 reported deals in Chile during 2013 for an aggregate amount of US$679 million, an increase by volume compared with 2012 when the aggregate amount of deals reached US$398 million. Conversely, as measured by deal count, the period showed a 14 per cent decrease according to publicly reported deals (anecdotal evidence suggests that the number and volume of actual new transactions, as opposed to only reported ones, was considerably higher in 2013). Exits also experienced an overall increase compared with the previous year, with seven exits consummated for an aggregate amount of US$164 million (as compared with three exits in 2012 for US$139 million).

5 Ibid.

6 Ibid; 2012 - 2013 LAVCA Mid-Year Reports.

The table below shows reported deals in Chile during 2013 compared with deals in other countries in the region:

Country breakdowns	*2013 investments*				*2013 v. 2012 growth*	
	Amounts		*Distributions*			
Country	*No. of deals*	*US$ deals (millions)*	*No. of deals*	*US$ deals*	*No. of deals*	*US$ deals*
Argentina	6	89	3%	1%	-45%	-8%
Brazil	147	6,027	63%	68%	-2%	7%
Chile	12	679	5%	8%	-14%	70%
Colombia	20	1,050	9%	12%	43%	155%
Mexico	30	651	13%	7%	43%	-5%
Peru	7	125	3%	1%	-42%	-53%
Uruguay	3	121	1%	1%	200%	N/A
Central America & Caribbean	3	56	1%	1%	-67%	-39%
Other	5	88	2%	1%	0%	-67%
Total	233	8,886	100%	100%	-2%	13%

Source: 2014 LAVCA Industry Data

The table below shows exits in Chile during 2013 compared with those in the other countries of the region:

Country breakdowns	*2013 exits*				*2013 v. 2012 growth*	
	Amounts		*Distributions*			
Country	*No. of exits*	*US$ exits (millions)*	*No. of exits*	*US$ exits*	*No. of exits*	*US$ exits*
Argentina	3	200	6%	5%	200%	N/A
Brazil	24	2,549	45%	68%	-8%	-28%
Chile	7	164	13%	4%	133%	18%
Colombia	3	151	6%	4%	-25%	205%
Mexico	9	634	17%	17%	80%	1,637%
Peru	3	20	6%	1%	0%	-71%
Central America & Caribbean	4	6	8%	0%	100%	140%
Total	53	3,724	100%	100%	20%	-3%

Source: 2014 LAVCA Industry Data

ii Operation of the market

The terms of private equity deals are fairly consistent with US industry standards. Frequently, transaction documents are based on US forms (including contracts drafted in English). Usual terms include representations and warranties, purchase price adjustments, anti-dilution provisions (including full ratchets), affirmative and negative covenants, events of default, indemnities and non-compete clauses. Shareholders' agreements are generally used for the corporate governance of the target company and to restrict the transfer of shares for the benefit of the private equity sponsor.

In some cases, the private equity seller may agree to escrow arrangements to secure buyer claims until the lapse of the statute of limitations (generally five years). Arbitration is the preferred dispute resolution mechanism for these transactions in almost all instances.

A typical sale process starts with the negotiation by the parties of the basic terms and conditions of the transaction, typically in the form of a term sheet. Term sheets may include indicative offers subject to due diligence conditionality. Often, the buyer will conduct the due diligence before the announcement of the transaction to the market, but a fair number of deals are announced without any due diligence having been carried out. Diligence 'outs' remain the norm, but it is standard practice for sellers to impose minimum thresholds and objective tests. Definitive purchase agreements will still be subject to conditionality, especially as they are relevant to governmental authorisations. For instance, in concentrated markets the approval of the antitrust authority will be a likely requirement, and transactions in the utilities sector will also require approval by the relevant authority (the sanitary authority in the water industry, the energy authority in the electric industry, etc.). If the sale process involves an initial public offering (IPO), prior approval by the Securities and Insurance Commission (SVS) will be required.

Unless there is an IPO, a deal will typically take between three and six months to close (of course, depending on the negotiations of the parties and the complexities of the deal, a particular transaction may take longer or shorter to close).

The management of portfolio companies usually have a significant portion of their compensation tied to stock options and other rewards linked to the performance of the company. Alignment of incentives and favourable tax treatment make this type of compensation very desirable in Chile.

II LEGAL FRAMEWORK

Chile allows for a number of corporate entities with different results in terms of control. A Chilean corporation is managed by a board of directors, with certain specified decisions reserved to the shareholders.

A corporation can be publicly traded, or 'open', private or 'closed'. An open corporation is one that has issued equity shares registered with the SVS. Registration is voluntary, except where the corporation has 500 or more shareholders, or if at least 10 per cent of its capital stock is held by at least 100 shareholders. Open corporations are supervised by the SVS. All other corporations are closed. Closed corporations are not subject to the supervision of the SVS unless they are issuers of publicly traded securities (whether equity or debt) or if otherwise required by a special regulatory frame (e.g., insurance companies).

Corporations are managed and controlled by a board of directors appointed by the shareholders. The board has the broadest authority over the corporation and its affairs. Closed corporations must have at least three board members, open corporations at least five.[7]

7 An open corporation with a market capital capitalisation over a certain threshold (currently about US$50 million) must have at least seven board members.

There are statutory withdrawal rights for shareholders pursuant to which a shareholder can put its shares to the corporation upon certain actions being approved.[8] Corporations in Chile require at least two shareholders.

Chilean law also provides for a corporate type similar to Delaware's limited liability company, with two critical distinctions: Chilean limited liability companies (LLCs) require a minimum of two members, and Chilean LLCs require unanimous consent to amend their charter in any respect, to accept new members or to allow existing members to assign their interest.

Share companies (SpAs) combine the best attributes of a corporation (free assignability of the equity interests) with the contractual flexibility of an LLC (the SpA does not require unanimous consent for amendments of its charter). An SpA can be formed by one or more persons (individuals or legal entities), and allows for any type of corporate agreement save for a few mandatory rules.

SpAs allow for a single equity holder and can have as many equity holders as desired. If an SpA, however, reaches the number of equity holders that would render a corporation an open corporation, then it will automatically become an open corporation.

If provided for in their charter, SpAs are allowed to make capital calls and issue equity interests if resolved by management (i.e., without the consent of the equity holders). Unlike corporations, there are no statutory pre-emptive rights (again, except as contemplated by the organisational documents). The organisational documents may indicate minimum or maximum percentages or amounts of capital that are to be directly or indirectly controlled by one or more shareholders. The repurchase of their own equity interests is allowed for SpAs. Contrast this with corporations, which can make capital calls only if agreed by the shareholders. Statutory pre-emptive rights apply to equity issuances by a corporation. Corporations are also generally prohibited from acquiring their own shares and must distribute minimum statutory dividends (at an amount of 30 per cent of net earnings).

Most notably, however, an SpA may issue preferred shares accruing fixed or variable dividends. Features like preferred dividends accruing from specific businesses or assets are permitted.

Chile also has investment funds. These can be structured as public funds (which are subject to substantive regulations by the SVS restricting the type and amount of assets in their portfolios, transactions with affiliates and periodic reporting to the market) or private funds (which are not subject to such regulations). Only public funds can publicly offer their securities.

8 Actions such as, *inter alia*, the conversion of the corporation into a different corporate type (LLC, SpA, etc.), a division or a merger of the corporation, a sale of substantially all of the assets of the corporation or the granting of guarantees or liens with respect to third-party obligations result in statutory withdrawal rights. A corporation's charter may provide for additional withdrawal rights.

i Sponsors' controlling investment of an entity

A sponsor seeking control of an investment in Chile will have to consider the specific features of each type of corporation.

Where the sponsor wishes to acquire control of a corporation, it will require at least the control of the number of shares required to control the board of directors and corporate decisions in shareholders' meetings – typically a majority of the outstanding shares. A number of material corporate actions require approval by at least two-thirds of the outstanding shares.[9] Some of those actions (such as the sale of more than 50 per cent of the assets and the creation of preferred shares) are material to private equity or venture capital sponsors. No corporate actions require unanimous consent of the shareholders.

Chilean law explicitly recognises shareholders' agreements and provides that they need to be 'deposited' with the corporation as a condition of the parties to it making claims against third parties based on such agreements. Chilean law, however, provides that shareholders' agreements are not enforceable against open corporations insofar as they create restrictions on the transfer of shares.[10] As a result, frequently liquidated damages clauses are agreed to by the parties in amounts large enough to create the appropriate incentives.[11]

SpAs provide the broadest flexibility in terms of contractual structuring provisions. The express recognition by the statute of contractual requirements in terms of maximum (or minimum) levels of equity interests held by its members, the fairly broad flexibility to trigger increases or reductions in equity capital and the ability to repurchase their shares, *inter alia*, make SpAs highly desirable vehicles for private equity investors.

Uniquely, SpAs' charters can provide for 'squeeze-outs', whereby a minority holder can be forced to sell its interest upon another holder acquiring a certain threshold percentage. SpAs also allow for preferences consisting of multiple vote shares (and shares without voting rights).

In summary, a private equity sponsor will benefit significantly from the flexibility provided by an SpA when setting up a holding vehicle for its investment. By the same token, a sponsor investing in an existing SpA will need to conduct thorough due diligence and understand the implications of the SpA's organisational documents.

ii Structuring considerations for sponsors not domiciled in Chile

The key structuring considerations will be driven by control issues (as previously discussed), tax issues and the regulatory framework relevant to the industry in which the investment is made. For example, a number of activities in Chile have to be – at least directly – performed by corporations (banking, insurance, retirement funds administrators, etc.). In addition, corporations are the only corporate entity that allow for an IPO.

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9 Actions such as, *inter alia*, the conversion of the corporation into a different corporate type (LLC, SpA, etc.), a division or merger of the corporation, a sale of more than 50 per cent of its assets, a decrease in its equity capital, the valuation of equity contributions made in assets other than cash or a reduction in the number of members of the board of directors.

10 Section 14 of the Chilean Corporations Act.

11 In general, liquidated damages clauses are enforceable in Chile even if they are considered a 'penalty' or do not bear a direct relation to the expected damages caused by the breach of the relevant obligation.

Similar to US tax law, Chilean law creates incentives for the use of leverage in a private equity transaction. Subject to certain conditions, Chilean tax law allows for tax deductions on account of interest payments. The same deduction does not exist for dividend payments.

Ordinarily, dividends remitted to non-Chilean sponsors are subject to a 35 per cent withholding tax rate. Interest payments are taxed at the same 35 per cent rate, but a 4 per cent reduced withholding rate applies, *inter alia*, to interest payments on loans made by foreign banks and financial institutions. In some cases, however, such as when the debt is guaranteed with cash or cash equivalents provided by third parties, in order to qualify for the reduced 4 per cent rate a 3:1 debt-to-equity ratio will have to be satisfied.

When structuring a transaction as a leveraged buyout, sponsors will have to ensure that the *pro forma* amount of debt of the target company (including the debt raised to finance the LBO) allow the surviving company to remain solvent. Chilean bankruptcy courts have jurisdiction to void transactions resulting in insolvent entities.

It is common to bridge a leveraged deal using short-term debt and then to refinance with long-term securities in the bond market.

Another reason for leveraging up a deal is that remittances of equity contributions to a foreign sponsor are first allocated to taxable retained earnings and profits. Accordingly, outflows of capital contributions can only be tax free if the Chilean business does not have accumulated earnings and profits that are taxable. There is no such requirement affecting principal payments on debt transactions.

iii Fiduciary duties and liabilities

The main source of fiduciary duties in the Chilean corporate context is the Corporations Act.[12] Directors of a corporation have an obligation to act with the degree of care and diligence that they would apply in their own affairs. They are jointly and severally liable for damages caused to the corporation or its shareholders for their fraudulent or negligent actions. The same principles apply to an SpA, unless it is not managed by a board of directors.[13]

As a result, a private equity sponsor will not be directly exposed to liability with regard to other shareholders. The shareholders of a corporation (or an SpA) do not generally owe fiduciary duties to each other, and are permitted to act in their own self-interest.

Areas of concern for a sponsor arise in the insolvency context. While the Chilean courts do not apply the 'zone of insolvency' test to the same extent that a court in the United States might,[14] the Chilean Bankruptcy Act[15] does provide for liability on account

12 Section 41.

13 Section 424 of the Chilean Commercial Code.

14 Delaware courts have created the 'zone of insolvency' concept, effectively extending fiduciary duties of a board of directors to creditors when a corporation is close to insolvency. See *Credit Lyonnais Bank Nederland, NV v. Pathe Communications Corp*, 1991 WL 277613 (Del Ch 30 December 1991); *Weaver v. Kellogg*, 216 BR 563, 582-84 (SD Tex 1997); *Official Comm of Unsecured Creditors of Buckhead America Corp v. Reliance Capital Group, Inc (In re Buckhead Am Corp)*, 178 BR 956, 968 (D Del 1994).

15 Sections 287 to 293.

of actions that are fraudulent to creditors. For example, Chilean courts may void a sale of assets consummated within a year of the insolvency of a company. They are, however, very unlikely to find liability for a sponsor other than in the very narrow circumstances of a fraudulent voidable transaction expressly provided for in the Bankruptcy Act or under criminal fraud statutes.

Recent experience confirms the liability shield for sponsors. The *La Polar* case has resulted in a large number of claims and litigation (including criminal prosecutions), but none against the private equity sponsor.

La Polar is a large retail company. It was controlled by Southern Cross for a number of years, during which La Polar appears to have, in what seems to have been a common practice, unilaterally (i.e., without the knowledge, let alone the consent, of its clients) changed the terms (including pricing) and conditions of retail loans to its customers. The practice was allegedly on a grand scale, and has resulted in several members of the management team (including the CEO and the CFO) being subject to criminal prosecution. In this situation, litigation has been initiated against the company itself, the management and some individual members of the board. No litigation has been initiated against Southern Cross (the manager of the fund that controlled La Polar) or against any investors in the fund. Several years into the La Polar fiasco, the limited liability of the sponsor and the limited partners in a fund is still holding firm in Chile.

III YEAR IN REVIEW

i Recent deal activity

Following a region-wide decrease in activity in Latin America during 2014, the Chilean private equity industry experienced a significant decrease in deal activity during the first half of 2014.[16] An upswing became evident during the second half of 2014. For example, Aurus, an active participant in the Chilean private equity and venture capital market, launched a new fund partnering with the Japanese Mitsui & Co and the state-owned Chilean Copper Company (CODELCO), *inter alia*, which is expected to see US$80 million being invested in the mining technology sector. Another active player in the Chilean market, Linzor Capital Partners, invested US$20 million in Komax, a holding company that controls certain retail brands in Chile and Peru.

Not all activity in 2014 was carried out by existing market participants. The Chilean–American private equity fund Magma Partners, which was launched in 2014 with US$5 million, added Deenty, an online dentist search platform dubbed 'the Google of Chilean dentists', to its portfolio.

ii Financing

From a regulatory standpoint, it is worth noting that Chilean institutional investors, especially pension funds, are a key source of liquidity for private equity in Chile. They can only invest, however, in publicly traded entities, and face significant restrictions if investing in foreign investment vehicles. As a result, international private equity firms

16 Diario Financiero, 8 October 2014.

generally use local feeder funds to raise capital from institutional investors. Banks are also authorised to participate in private equity deals through their affiliates. Restrictions on the amounts invested (determined as a percentage of their assets) apply.

The Chilean Economic Development Agency (CORFO), the state development agency, is a significant source of financing for private equity and venture capital. CORFO encourages entrepreneurship and innovation by providing resources to start-ups or in key sectors of the economy. CORFO can provide direct financing (up to 40 per cent of the equity of a company) or financing through lines of credit available to private equity or venture capital investors. CORFO's financing can be unsecured, thereby allowing for additional third-party leverage on a secured basis. By the end of 2013, CORFO had committed US$314 million to venture capital investments for the 2012–2013 period, notably exceeding funds invested in the industry in prior years.

iii Exits

The most important recent exit was the sale by Southern Cross in 2013 of its 50 per cent stake in Chile in GasAtacama to power conglomerate Endesa Chile for US$309 million.[17] With this acquisition, Endesa became the sole owner of the GasAtacama power project.

IV REGULATORY DEVELOPMENTS

i Regulatory bodies of the industry

Except for specific instances in the context of regulated industries, private equity transactions are generally not subject to special regulations restricting them. If a transaction involves public investment funds or public companies, a private equity sponsor is likely to have to deal with the SVS, which may exercise its overseeing powers. Private investment funds and private companies (including SpAs), on the other hand, are not supervised by the SVS.

For an IPO, both the issuer and its securities to be offered to the public need to be registered with the SVS. An application describing in detail the terms and conditions of the offer is required, and must include extensive information regarding the company (ownership structure, legal information, accounting, business and activities, risk factors, etc.) and its securities. The SVS has ample discretion to approve an application, and usually it will exercise it by asking for further information and for changes to the way information is presented. Once the observations are resolved, the issuer and the shares will be registered in the Securities Registry of the SVS. The SVS making observations is very common; however, an application not ending in an approved registration is extremely unusual.

ii Regulatory developments

Chile is adopting policies to establish itself as the entrepreneurial hub of Latin America.[18] These policies are part of the reform informally referred to as 'MKB', a (somewhat

17 2014 LAVCA Mid-Year Report.

18 See *The Economist*, 13 October 2012 edition, referring to Chile as 'Chilecon Valley'.

playful) acronym combining the ideas of capital markets reform and the bicentenary of Chile's independence. MKB intends to boost innovation and competition, as well as opening the Chilean financial market internationally. MKB includes reforms in several areas: taxation, consumer protection, the banking system, information and transparency at the governmental level, improvement of government performance, capital markets, access to new markets and improved financing.

As part of these measures, 2012 was declared by the government as the 'year of entrepreneurship' and 2013 as the 'year of innovation'. In addition, and notwithstanding that the cost of starting a business is already one of the lowest of the region,[19] a law was enacted in 2013 that permits the incorporation of the different types of legal entities (including closely-held corporations, LLCs and SpAs) essentially for free and within a day. The statute provides an alternative to the required formalities for the incorporation of companies by permitting that the incorporation, modification, conversion, merger, spin-off or dissolution all be effected using an online electronic registry.

In 2014, a new law entered into effect – the Unified Law on Funds – which is intended to transform Chile into a platform for the management of financial assets across the region. The new statute sets a common framework, and simplifies the legislation on investment funds and mutual funds in order to simplify and make their legal and regulatory framework consistent.

The Unified Law of Funds includes tax incentives, such as a tax exemption for foreign nationals investing in funds that hold more than 80 per cent of their assets outside Chile, as well as an exemption from value-added taxes on the portion of the management fees payable to an investment fund's manager related to fund interests held by non-residents. The government projects a threefold increase in investment fund activity as a result of the Unified Law of Funds having been enacted.

Another regulatory development has been a complete replacement of the bankruptcy and insolvency regime in Chile, which entered into effect on 10 October 2014. Under this new regime, a workout and reorganisation process similar to Chapter 11 of the United States Bankruptcy Code is favoured over the previously existing liquidation approach. This reform is expected to significantly reduce the amount of time that a company or person spends either in reorganisation or liquidation.

Chilean tax regulations were also extensively reformed during 2014, with reforms including the following:

a an increase in corporate income tax;
b a new alternative regime for withholding taxes;
c new sourcing rules for debt instruments;
d more stringent rules for the capital gains tax regime;
e new rules setting forth that passive income of a foreign entity would be recognised on an accrual basis by the Chilean-resident controlling taxpayers;
f new tax haven and transfer pricing rules;
g new real estate taxation rules;
h an increase in the stamp tax rate;

19 See LAVCA Scorecard 2012.

i interest deductibility rules for loans destined to acquire shares, equity rights, bonds and other similar assets; and

h new general anti-avoidance rules establishing that obligations are triggered and payable in accordance with the legal nature of the business or acts carried out by taxpayers, regardless of their form, denomination or flaws.

Many of these rules have not yet fully entered into effect, and as such their impact on the private equity and venture capital landscape has yet to be determined.

A key aspect of the tax reform is the increase on the corporate tax burden for Chilean companies from the current 20 per cent rate to 25 or 27 per cent, depending on the regime companies adopt. For this purpose, the tax reform provides for two new tax regimes: (1) an attribution regime that levies a 25 per cent tax rate on incomes obtained by companies in each tax year, which will be immediately allocated to their shareholders; and (2) a partially integrated regime that levies with 27 per cent tax rate incomes obtained by companies. Under the second regime, shareholders are allowed to defer personal and withholding taxes until such profits are effectively distributed, but it only allows the use of a 65 per cent credit of the taxes paid by the company, unless the shareholder is resident in a tax-treaty country.

Further developments in the Chilean regulatory landscape have also taken place during 2013 and 2014 due to regulatory actions and lawsuits brought by the SVS, which have become known as 'waterfall cases' in reference to the flow of funds between subsidiary companies and shareholders. The waterfall cases are essentially stock sales between affiliate parties that allegedly resulted in losses to the minority shareholders (most notably pension funds) and gains to the controlling shareholders and related investment vehicles. The SVS handed out the largest fines ever imposed by it to the indicted parties. These actions have brought to the regulator's attention the manner in which publicly traded shares are sold, transactions between public issuers and their majority and minority stakeholders, transactions with affiliates, and the role and operations of securities intermediaries.

V OUTLOOK

Chile has a competitive economy and a well-developed business environment. It has in place a smart regulatory framework with the necessary conditions to attract new investors and the private equity industry in general.

The new policies being implemented to improve the regulatory framework for investors in Chile, the continued growth of Chile's economy, the relatively early stage of the private equity industry in Chile and the number of exits over the recent past suggest the continued growth of the private equity industry in the country.

Chapter 6

CHINA

Frank Sun and Cheryl Yuan[1]

I OVERVIEW

Private equity activity in China in 2014 bounced back strongly from the relatively low ebb in 2012 and 2013, hitting a record high surpassing even 2011 in terms of value of investments, and generally stayed in line with 2012 and 2013 in terms of volume of investments. According to AVCJ Research, the market research division of the *Asian Venture Capital Journal*, there were 792 private equity investments (of which 539 were publicly disclosed) with an aggregate amount invested of US$35.4 billion in China during 2014. Compared with 813 investments with an aggregate amount invested of US$20.7 billion in 2013, the total volume of investments decreased by 2.6 per cent but the total value of investments increased by 70.7 per cent in 2014. Zero2IPO research, a research institution maintained by private equity service provider and investment institution Zero2IPOGroup, reported that there were 943 private equity investments in China during 2014 with an aggregate amount invested of US$53.8 billion, representing a 42.9 per cent increase in terms of deal numbers and an extraordinary 119.6 per cent increase in terms of deal values from 2013. Although different sources use different methodologies to calculate the volume and value of private equity investments, major sources appear unanimous in their assessment that private equity investment activity in China has fully rebounded during 2014 compared with 2013 and 2012.

1 Frank Sun is a partner at Kirkland & Ellis and Cheryl Yuan is a partner at Kirkland & Ellis International LLP. The authors wish to give special thanks to their Kirkland & Ellis Asia colleague Kanglin Liu for his significant contributions to this chapter, as well as other Kirkland & Ellis Asia colleagues Pierre Arsenault, David Patrick Eich, Chuan Li, Gary Li, Douglas Murning, Angela R Russo, Jesse Sheley, Lily Qian, Stephanie Tang, Samuel G Williamson, David Zhang and Tiana Zhang for contributing to this chapter.

The distribution among different investment types in 2014 exhibited a pattern largely similar to that of 2013. According to AVCJ Research, expansion and growth capital stayed ahead of other investment stages at 49.8 per cent of total investment value in 2014, down slightly from 50.9 per cent in 2013; private investments in public enterprises (PIPEs) rose to above US$5 billion or 14.2 per cent of total investment value in 2014, after its retreat in 2013 with US$3.2 billion or 15.6 per cent of value; and buyouts ascended from US$3.8 billion or 18.2 per cent of value in 2013 to US$5.3 billion or 15.1 per cent of value in 2014. According to Zero2IPO, growth equity investments, which accounted for 79.6 per cent of the number of private equity deals and 64.3 per cent of the total invested amount in China in 2014, increased even further from 2013 and remained the dominant type of private equity investment; PIPEs accounted for 12.2 per cent of the number of deals and 18.4 per cent of the invested amount; and buyouts remained a relatively small portion of private equity investment activity, accounting for only 1 per cent of the number of deals and 3.5 per cent of the invested amount.

Although buyouts remained relatively rare in comparison with deal activity in many other jurisdictions; the trend that began in 2010, emerged in 2011, and grew in 2012 and 2013 of going-private transactions involving China-based companies, particularly companies listed in the United States, continued in 2014. Of the 111 going-private transactions that have been announced since 2010, 27 did not proceed (eight of which involved private equity sponsors) and 72 have closed (five in 2010, 11 in 2011, 18 in 2012, 16 in 2013, 21 in 2014 and one as of January 2015). As of January 2015, 12 going-private transactions were ongoing, including one announced in 2011, three announced in 2012, four announced in 2013, three announced in 2014 and one announced in 2015. Of the 72 completed transactions, 21 involved private equity sponsors, and of the 12 ongoing transactions, as of January 2015, two involved private equity sponsors.

In respect of exits via IPO, from November 2012 through December 2013, China experienced the longest moratorium of A-share IPOs in history. Private equity-backed IPOs in 2013, on which there used to be huge dependence by China-focused private equity funds for exits, declined from 2012 by 64.3 per cent and 44.3 per cent in terms of volume and value, respectively, according to AVCJ Research (comparable figures from CVSource are 69.07 per cent and 33.22 per cent), inarguably touching a five-year low. One highlight in 2013 for private equity-backed IPOs was the debut of China Cinda Asset Management Co, Ltd, which ranked as the second-largest offering in Hong Kong in 2013, with a value of around US$2.45 billion and with a suite of investors including Och-Ziff Capital Management Group, Norges Bank Investment Management, Farallon Capital Management and Oaktree Capital. Another record-breaking highlight for IPOs in 2014 was the IPO of Alibaba on Nasdaq, raising US$25 billion and high returns for its private equity investors including China Investment Corp, Silver Lake, Yunfeng Capital, Citic Capital and Boyu Capital.

Exits via trade sales and secondary sales have been predicted by some commentators to become an important (and perhaps dominant) exit option for private equity funds in future. One most recent highlight in this respect is the ongoing sale by two funds affiliated with China International Capital Corporation of their 32 per cent equity interest in Jiangyin Tiangjiang Pharmaceutical Co, Ltd, China's largest manufacturer of concentrated traditional Chinese medicine granules, to Hong Kong-listed China

Traditional Chinese Medicine Co Limited in a transaction announced in January 2015, which valued the target at over US$1.5 billion.

II REGULATORY FRAMEWORK

i Acquisition of control and minority interests

China's Companies Law, which became effective on 1 January 2006 and was amended in 2013 with effect from 1 March 2014, sets out the governance framework for the two types of Chinese companies: the company limited by shares (CLS) and the limited liability company (LLC). A Chinese entity in which a non-Chinese investor owns an equity interest is called a foreign-invested enterprise (FIE), of which there are several types, including a wholly foreign-owned enterprise (WFOE), an equity or cooperative joint venture, and a foreign-invested company limited by shares (FICLS). FIEs are subject to separate statutes in addition to the Companies Law, including the Law on Wholly Foreign-Owned Enterprises (which applies to a WFOE), the Law on Sino-Foreign Equity Joint Ventures and the Law on Sino-Foreign Cooperative Joint Ventures (which respectively apply to the two types of joint ventures), and the Interim Provisions on the Establishment of Foreign Invested Companies Limited by Shares (which applies to a FICLS), including their respective implementation rules. The Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (M&A Rules), jointly issued by six Chinese governmental agencies in 2006 and amended in 2009, establish a general legal framework in which non-Chinese investors can acquire the equity or assets of a Chinese company. Other statutes and rules govern transfers of equity, mergers and other transactions involving FIEs.[2]

On 19 January 2015, the central Ministry of Commerce (MOFCOM) released a draft of the proposed new Foreign Investment Law (Draft FIL) for public comment. The Draft FIL proposes sweeping reforms to the current Chinese foreign investment legal regime by removing many distinctions between FIEs and Chinese domestic entities and streamlining the oversight of foreign investments, and raised much uncertainty as well. If the Draft FIL were to be formally promulgated, the Law on Wholly Foreign-Owned Enterprises, the Law on Sino-Foreign Equity Joint Ventures and the Law on Sino-Foreign Cooperative Joint Ventures would likely be repealed, while other statutes and rules on foreign investments would require amendments or replacements to adapt into the new regime.

Government approval regime

An acquisition of or investment in a Chinese company by a non-Chinese investor is subject to a multi-layered government approval and registration process. The highest

2 These rules include the Certain Provisions on Change of the Equity Interests of the Investors of a Foreign-Invested Enterprise, the Provisions of the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce on Merger and Division of Foreign-Invested Enterprises, and the Interim Provisions on Investment Made by Foreign-Invested Enterprises in China.

scrutiny is directed at an onshore investment (that is, a direct acquisition of equity in a Chinese company), which requires the approval of the National Development and Reform Commission (NDRC) or its local counterpart and central MOFCOM or, if the size of the transaction falls below US$300 million (or US$50 million if the investment directs to 'restricted' sectors specified in the Foreign Investment Catalogue, as discussed below), MOFCOM's local counterpart. Approval at the local level typically can be obtained within one month, but approval from central MOFCOM and the NDRC often takes several months or longer. If a transaction is subject to antitrust or national security review as discussed below, MOFCOM or its local counterpart typically withholds approval until such reviews are cleared.

Whether MOFCOM and the NDRC will grant approval of a transaction depends in part on the Catalogue for the Guidance of Foreign Investment Industries (Foreign Investment Catalogue), jointly published by MOFCOM and the NDRC, which classifies sectors of the Chinese economy as 'prohibited', 'restricted' or 'encouraged' (with unclassified sectors deemed as 'permitted'). Whereas a non-Chinese investor can acquire full ownership of a company in most 'encouraged' and 'permitted' sectors (and often benefits from special advantages when acquiring a company in an 'encouraged' sector), to invest in most 'restricted' sectors, a non-Chinese party is required to team up with a Chinese partner (and, in some cases, the Chinese partner must maintain a controlling stake). Investments by a non-Chinese party in a 'prohibited' sector are typically prohibited regardless of what percentage of the target is acquired.

In addition to these general approval requirements, foreign investment in several industries, such as construction or telecommunications, is subject to approval from the regulatory authorities governing the applicable industry.

An indirect investment in China by way of an investment in an offshore holding company that owns equity of a Chinese FIE is not subject to the MOFCOM or NDRC approvals applicable to an onshore investment; however, both an onshore and an offshore investment may be subject to China's antitrust and national security review schemes.

Under the Anti-Monopoly Law (AML), which became effective 1 August 2008, an antitrust filing with MOFCOM is required for any transaction involving a change of control if the individual sales in China in the prior accounting year of each of at least two of the parties involved exceed 400 million renminbi and either the parties' aggregate worldwide sales in the prior accounting year exceed 10 billion renminbi or the parties' aggregate sales in China in the prior accounting year exceed 2 billion renminbi. In February 2014, MOFCOM issued the antitrust review regulations on simple cases, by which it is expected that MOFCOM will review and clear simple mergers in a more time-efficient manner. Throughout 2014, MOFCOM received 262 merger notifications (17 per cent more than in 2013) and closed 245 cases (18 per cent more than in 2013), among which MOFCOM imposed conditions on four transactions (the same number in 2013) and permanently blocked, for the second time ever in the history of MOFCOM antitrust review (after it blocked Coca-Cola's acquisition of Huiyuan in 2009) the proposed shipping alliance that would have created a long-term vessel-sharing agreement between Denmark's AP Møller-Maersk A/S, Switzerland's Mediterranean Shipping Company and France's CMA CGM. In late 2014, MOFCOM, for the first time, imposed fines on two merger transactions, because one transaction was consummated without filing the required antitrust filing and another transaction involved a violation of a condition imposed by MOFCOM in its clearance decision.

In February 2011, China's State Council issued Circular 6, which established a national security review scheme for the acquisition of a Chinese business by one or more non-Chinese investors. Two broad transaction types are subject to Circular 6 review: the 'acquisition' of any stake (regardless of the size) in a military enterprise, a supplier to a military enterprise, a company located near sensitive military facilities or any other company relating to national defence; and the 'acquisition' involving 'control' of a Chinese company whose business involves 'key' agricultural products, energy and resources, infrastructure, transportation services or technologies or manufacturing of equipment and machinery 'affecting national security'. The Draft FIL has attempted to codify the national security review into the organic whole of foreign investment regime and seeks to broaden the scope of review by expressly allowing all types of foreign investment (not limited to 'acquisition') to trigger the review and enhancing the list of factors taking into account in the review.

Both China's antitrust and national security review schemes provide Chinese authorities with wide discretion to determine whether a transaction is subject to review or, if subject to review, whether it should be blocked. Under Circular 6, the meanings of 'key' and 'affecting national security' are undefined. Provisions issued by MOFCOM in 2011 to implement Circular 6 prohibit an investor from circumventing the national security review by structuring a transaction by way of nominee arrangement, trust, multilayered re-investment, lease, loan, contractual control, offshore transaction or other such structures. Under both the AML and Circular 6, 'control' is defined broadly and includes having voting rights sufficient to exercise a major impact on board or shareholder resolutions, particularly with respect to key business or operational decisions. As such, private equity investments involving certain customary protections (e.g., veto rights, supermajority voting requirements, negative covenants) arguably could be interpreted to involve 'control' under both statutes. If there is ambiguity as to whether a filing is required, it is usually prudent for an investor to make a filing in order to avoid adverse consequences later. In June 2014, MOFCOM issued the revised guidelines on antitrust filings, with attempts to clarify the moderately controversial concept of 'control' in the context of antitrust filing and provide for a formal pre-filing consultation with the Anti-Monopoly Bureau of MOFCOM available for investors to determine whether a filing would be triggered. If a transaction is subject to national security or antitrust review, MOFCOM conducts a policy-driven review process to determine whether the transaction can proceed unimpeded: it considers not only the effect of a transaction on national security or competition, as applicable, but also takes into account its effect on the public interest and the stability of the national economy and social order, as well as the views of industry associations and other market participants.

The M&A Rules contain, in effect, a restriction on 'round-trip' investments by requiring approval by MOFCOM of any acquisition of a Chinese company by an offshore company formed or controlled by any Chinese entity or individual affiliated with the Chinese target company. Ordinarily, this approval is not granted. Where the offshore structure was in place prior to the adoption of the M&A Rules in 2006, however, the acquisition of a Chinese target by the offshore entity is still permitted.

In contrast, the Draft FIL is proposing a shift from current case-by-case approval for all foreign direct investments to a refined regime, namely an 'entry clearance review', applicable only to foreign investments in 'restricted' sectors on a Negative List that is to be promulgated (which, it is expected, will supersede the Foreign Investment Catalogue). However, as the Draft FIL has materialised, the concept of '*de facto* control' to be adopted by MOFCOM in determining whether an entity will be treated as an FIE or a Chinese domestic entity and assessing whether certain foreign investors may participate in those sectors spelled out on the Negative List, certain types of indirect investments may unprecedentedly come within the purview of Chinese regulators.

Governance of and exit from onshore joint ventures

The Chinese corporate law and regulatory framework applying to FIEs make it difficult for shareholders in a Chinese company to obtain or enforce contractual rights that are considered fundamental for private equity investors in other jurisdictions, including rights pertaining to governance and exit. First, members of an onshore equity joint venture have rights of proportional representation on the board, meaning that a Chinese partner typically has the right to appoint at least one director. Further, certain important corporate acts of any joint venture must be unanimously approved by the board, including:

a any amendment to the articles of association (which is required in connection with any equity transfer);

b any liquidation or dissolution;

c any increase or decrease in registered capital; and

d any merger or division.

As a result, a non-Chinese investor with a majority stake in a joint venture cannot obtain complete control because the minority partner has statutory veto rights via its representative on the board.

Moreover, it may be difficult for a non-Chinese investor to enforce certain exit-related provisions that are often key terms of a private equity investment. Transfers of equity in an onshore joint venture are subject to a statutory consent right and right of first refusal by all other members. Theoretically, such rights can be waived in advance in the joint venture contract. In practice, however, a transfer of a shareholder's interest in a Chinese joint venture requires amendments to the joint venture contract and articles of association as well as the approval of MOFCOM or its local counterpart. Because an amended joint venture contract (which MOFCOM expects to review in order to approve a transfer) requires signatures from all shareholders, the other shareholders' cooperation is necessary in connection with any transfer. The same difficulties arise for a private equity investor seeking to enforce a call right, put right or drag-along right against the Chinese shareholders (a tag-along right is easier to enforce, as the party with the tag right can attempt to block a transfer if the transferor fails to comply with the other shareholders' tag-along right). If the Chinese shareholder is a state-owned enterprise (SOE), enforcement is even more difficult, as a transfer of an SOE's interest in a joint venture is subject to a statutory appraisal and an open bid procedure, unless waived by the appropriate authorities. Regardless of what rights may be contained in a joint venture contract, a local Chinese court injunction granting specific performance against a Chinese shareholder and in favour of a foreign investor is far from certain.

Implications of regulatory framework on transaction structure

To avoid the requirements of obtaining NDRC and MOFCOM approval and to enhance structuring flexibility, foreign private equity investors typically prefer to invest in China through an offshore investment. The ideal transaction structure, when feasible, is for the foreign investor to invest alongside a Chinese partner in an offshore Cayman or British Virgin Islands company, with such company owning 100 per cent of a Chinese WFOE (often indirectly through a Hong Kong entity, to obtain preferential treatment on dividends). This structure also allows the foreign investor to benefit from transaction agreements governed by foreign law and to avoid the need to enforce its rights in China. Because of foreign ownership limitations and the prohibition on 'round-trip' investments, however, this offshore structure is seldom available for foreign investments in Chinese targets that have not formed an offshore holding structure prior to the effectiveness of the M&A Rules.

Many non-Chinese investors use a 'variable interest entity' (VIE) structure to invest (indirectly) in China without seeking Chinese regulatory approval. Under a VIE structure, Chinese individuals, often the founders, are the registered shareholders of a domestic operating company, which holds the required licences and permits needed for the business to operate. An investor (often in conjunction with the founders) then forms a WFOE through an offshore entity it owns, and the WFOE enters into a series of contractual arrangements with the operating company and its registered shareholders pursuant to which the WFOE obtains control and an economic interest in such operating company. These contractual arrangements can take many forms, but often include an exclusive service or licence agreement, a voting proxy agreement, share pledge agreement and loan agreement, and an exclusive option agreement (together with a form of equity transfer agreement) allowing the WFOE or its affiliates to acquire the equity interests or assets of the operating company when permitted by Chinese law. Commentators frequently note that the VIE structure is legally risky given that it arguably violates the spirit (if not the letter) of Chinese regulations; however, Chinese companies continue to use this structure.

However, the Draft FIL is a strong signal from the government of its long speculated-upon attempts to address VIE structures, primarily by formalising the regulation of a VIE structure via the concept of '*de facto* control', as aforementioned. This warrants the vigilance of current and future investors and would have a profound impact on prospects of investment in certain Chinese businesses. The Draft FIL has clarified that future investments via VIE structures controlled by foreign investors will be treated as foreign investment, which may trigger entry clearance and other review. Further, instead of godfathering the pre-existing VIE structures, the Draft FIL leaves a placeholder for how pre-existing VIE structures would be handled under the new regime, while an explanatory note from MOFCOM accompanying the Draft FIL puts forth suggested approaches in dealing with businesses with VIE structures. In this note, MOFCOM has left room for public comments and undertakes to propose solutions upon further study.

ii Fiduciary duties and liability

Fiduciary duties of directors, officers and supervisors

The Companies Law is the primary statute regulating the actions and duties of directors, officers and supervisors of a Chinese company. Pursuant to the Companies Law, a director, officer or supervisor must abide by the laws, administrative regulations and articles of association of the company, and has a duty of loyalty and duty of care to the company. As in many other countries, a breach of duty may give rise to civil, administrative or criminal liability. A particular concern to a private equity investor in China, however, is that a director, officer or supervisor may be liable for criminal liability not only for his or her own wrongdoing, but also for crimes committed by the company if he or she is the 'manager directly in charge' or 'person directly responsible' for the management of the matter with respect to which a specific criminal act was committed. This risk of personal liability for company wrongdoing is more acute for a director or officer who is also the chair of the board, executive director or legal representative of the company or who otherwise serves in a senior management capacity, such as general manager or chief financial officer. Most non-Chinese private equity funds are comfortable appointing their representatives to the boards of Chinese companies notwithstanding the risk of liability, often while seeking to ensure that their representatives are not assigned responsibility for any specific matters. While directors and officers insurance and indemnification agreements may protect against civil liability, many types of administrative or criminal liability cannot be mitigated with insurance and indemnification.

Chinese tax exposure

Since January 2008, China's Enterprise Income Tax Law (EIT Law) has imposed a 10 per cent capital gains tax on the sale of a domestic Chinese company by a foreign investor. Pursuant to the State Administration of Taxation's (SAT's) Circular 698, issued in December 2009, a foreign investor that sells a Chinese company indirectly by selling the equity of an offshore holding company will be subject to this capital gains tax, unless it can demonstrate that the offshore holding company has a commercial justification other than tax avoidance. Because of the uncertainty regarding what will satisfy Chinese tax authorities as a non-tax-avoidance justification for using an offshore structure, many practitioners recommend building 'substance' in the non-Chinese holding company.

An offshore vehicle established by a non-Chinese private equity investor to make an investment in a Chinese company will be treated as a 'PRC-resident enterprise' under the EIT Law and will be subject to the uniform 25 per cent enterprise income tax on its worldwide income where such offshore vehicle's *de facto* management body is in China. Although the law is unclear, factors that the State Administration of Taxation may take into account in determining tax residency include whether:

a the offshore vehicle locates its senior management and core management departments in charge of daily operations in China;

b financial and human resources decisions of the offshore vehicle are subject to determination or approval by individuals or bodies in China;

c the offshore vehicle's major assets, accounting books, company seals, and minutes and files of board and shareholders' meetings are kept or located in China; and

d at least half of the offshore vehicle's directors or senior management reside in China.

To mitigate the risk that any dividends, sale proceeds or other income received by an offshore vehicle are subject to such tax, an offshore vehicle should take steps to establish that it is not effectively managed and controlled in China.

SEC enforcement actions

The SEC Enforcement Division has continued to focus on companies based in China but trading on the US exchanges. Prompted by concerns over the growing use of reverse mergers to gain access to the US capital markets without having to go through an IPO, the SEC launched in 2010 a Cross-Border Working Group to focus on companies with substantial foreign operations that are publicly traded in the US. To date, the Working Group has enabled the SEC to file fraud cases against more than 100 foreign issuers, executives and auditors and deregister the securities of more than 60 companies. This trend continued throughout 2014.

In the *AgFeed Industries* case, a litigated case, the SEC charged AgFeed and its top executives with conducting a massive accounting fraud that repeatedly reported fake revenues from their China operations in order to meet financial targets and prop up the stock price.[3] In addition to company management, the SEC also brought charges against a director, who was the chair of AgFeed's audit committee and allegedly participated in a scheme to avoid or delay disclosure of the accounting fraud once he learned about it in 2011. AgFeed was based in China and publicly traded in the US before merging with a US company in September 2010. The SEC alleged that company executives used a variety of methods to inflate revenue from 2008 to mid-2011, including fake invoices for the sale of feed and purported sales of hogs that didn't really exist. They later tried to cover up their actions by saying the fake hogs died. Because fatter hogs bring higher market prices, they also inflated the weights of actual hogs sold and correspondingly inflated the sales revenues for those hogs.[4] As a result of what the SEC referred to as a 'massive multi-year accounting fraud', AgFeed's revenue was allegedly inflated by US$239 million, ranging from an overstatement of revenue by approximately 71 per cent to 103 per cent and gross profit inflation ranging from approximately 98 per cent to approximately 153 per cent. In settling the litigation, AgFeed agreed to pay US$18 million in civil penalties. The SEC's case against the five former company executives and audit committee chair is ongoing.

In the *L&L Energy* case, the SEC alleged that L&L Energy, a Seattle-headquartered coal company with all of its operations in China and Taiwan – led by its chair and CEO – misrepresented in public filings with the SEC that L&L was run by a professional

3 See 11 March 2014 Press Release, 'SEC Charges Animal Feed Company and Top Executives in China and U.S. With Accounting Fraud', Rel. No. 2014-27, available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370541102314#.VE6cIJ0pDcs.

4 See 15 September 2014 Press Release, 'Tennessee-Based Animal Feed Company Agrees to Pay $18 Million to Settle Accounting Fraud Case', Rel. No. 2014-194, available at: www.sec.gov/News/PressRelease/Detail/PressRelease/1370542938017#.VE6dfZ0pDct.

management team and concealed the CEO's single-handed control of the company.[5] From approximately August 2008 to June 2009, the company repeatedly misrepresented to the public that it had certain persons serving in critical executive management roles at the company when, in reality, those persons served in no such roles. In a separate administrative action, the SEC charged a board member, who served as audit committee chair, for signing an SEC filing when she knew or should have known that the filing contained a false Sarbanes-Oxley certification. The SEC alleged that the audit committee chair learned of the fraud but failed to notify the company's auditors or the company's audit committee.

The charges brought against the outside directors and audit committee chairs in the *AgFeed* and *L&L* cases are consistent with the SEC's ongoing efforts to hold outside directors and other gatekeepers accountable for the important roles they play in the securities industry. Thus, in addition to actions against issuers, senior executives and directors, the SEC brought a number of cases against auditors for failing to conduct proper audits involving US-listed companies based in China. This past year, the SEC has brought such charges against over a dozen audit firms and auditors.[6]

The SEC also continued its battle to require certain Chinese auditors to turn over audit work papers in connection with SEC investigations of potential wrongdoing by certain US-listed Chinese companies audited by these accounting firms. The auditors, citing Chinese laws prohibiting such disclosure to foreign authorities, refused to comply. On 3 December 2012, the SEC charged five Chinese audit firms, namely the Chinese affiliates of the 'Big Four' and BDO, with violating the US Securities Exchange Act and the Sarbanes-Oxley Act, which requires foreign public accounting firms to provide the SEC upon request with audit work papers involving any company trading on US markets. After administrative proceedings during 2013, on 22 January 2014, the SEC Administrative Law Judge ordered that the Chinese affiliates of the 'Big Four' accounting firms should be suspended from auditing US-listed companies for six months. While the initial decision garnered significant market and media attention, the China Securities Regulatory Commission quickly responded, announcing on 24 January 2014 that the decision 'ignored' China's efforts and progress made on cross-border regulatory cooperation, and warning that there could be unspecified 'consequences'. Since that time, the parties have been in settlement talks to resolve the matter. Most recently, in a 12 December 2014 joint request to extend the briefing schedule in the administrative proceeding, the parties noted that 'substantial progress' had been made towards settlement, but that 'the multi-party nature of the negotiations, the importance, complexity and sensitivity of the matters under discussion, and the legal and cross-border regulatory

5 See 27 March 2014 Press Release, 'SEC Announces Fraud Charges Against Coal Company and CEO for False Disclosures About Management', Rel. No. 2014-59, available at: www.sec.gov/News/PressRelease/Detail/PressRelease/1370541317697#.VLhb-Z1OmM.

6 See, e.g., 17 December 2014 Press Release, 'SEC Imposes Sanctions Against Hong Kong-Based Firm and Two Accountants for Audit Failures', Rel. No. 2014-284, available at: www.sec.gov/news/pressrelease/2014-284.html#.VLiQrZ1OmM-.

issues presented have continued to require significant time and care to discuss'.[7] The parties requested a 70-day extension of the briefing schedule to continue such discussions, noting that this was anticipated to be the final request for an extension. All of this suggests that an announcement of a final resolution is imminent.

In addition to the SEC's enforcement action, the Public Company Accounting Oversight Board (PCAOB)[8] has been trying to obtain permission from the Chinese regulatory authorities to inspect Chinese audit firms, as part of its effort of conducting international inspection of PCAOB-registered accounting firms that are auditors of US-listed companies. The Chinese regulatory authorities balked at first, but negotiations continued, and in May 2013 the PCAOB indicated it had reached an agreement with the Chinese authorities to obtain access to audit work papers in connection with companies being investigated by the SEC. As of January 2015, the PCAOB had not yet been able to obtain an agreement providing the access required for the PCAOB's routine inspections of PCAOB-registered audit firms based in China. In theory, the PCAOB could deregister such firms if it cannot reach an agreement with China to gain inspection rights over them; US-listed Chinese companies would then be without their auditors and may have to be delisted. Jim Doty, the chair of the PCAOB, stated throughout the year that he expected to achieve an agreement in 2014 allowing inspections to go forward. However, no such accord has been reached, and recent press reports indicate that discussions between the Chinese and the PCAOB have run into some difficulties.

In May 2014, after years of investigations, beauty products company Avon agreed to pay a fine of US$135 million to the SEC and the DoJ to settle Foreign Corrupt Practices Act (FCPA) offences for improper payments to Chinese officials. In addition to the fine, Avon also agreed that its Chinese subsidiary would enter a guilty plea in connection with alleged violations of the books and records provision of the FCPA. According to media reports, Avon had spent about US$300 million on its internal FCPA investigation by the end of 2013.

In 2013, investment bank JP Morgan also came under US government scrutiny for allegedly improper practices in China and Hong Kong. The investment bank is suspected of having hired family members of head executives at state-owned companies in China with the express purpose of winning business and other contracts. The investigation by the SEC and the DoJ is ongoing. Apparently as a result of the inquiry and attendant publicity, JP Morgan ended IPO discussions with a large Chinese firm and earlier withdrew from underwriting a US$3 billion listing by China Everbright Bank Co.

7 See *In the Matter of BDO China Dahua CPA Co, Ltd, et al.*, Extension Order at 1, Exchange Act Release No. 73838 (15 December 2014), available at: www.sec.gov/litigation/admin/2014/34-73838.pdf.

8 The PCAOB is a non-profit corporation established by the US Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to US federal securities laws, to promote investor protection. See http://pcaobus.org/Pages/default.aspx.

Chinese authorities' enforcement actions

In addition to heightened scrutiny from US regulators, foreign private equity investors also face risks posed by Chinese authorities' anti-corruption enforcement actions. Such risks were showcased in their continuing anti-corruption enforcement actions against multinational companies.

Following a highly publicised investigation by Chinese regulators into GlaxoSmithKline (GSK) for illegal payments to Chinese public officials in September 2014, a Chinese court found that the Chinese subsidiary of GSK was guilty of bribery and ordered a US$489 million fine. Additionally, five of the company's managers, including its former top China executive, were convicted of bribery-related charges and received suspended prison sentences. The GSK sentencing marked the largest corporate fine in China to date and the first criminal conviction of a foreign company in China.

Chinese regulators continued their anti-corruption sweep in 2014 by launching investigations into the automotive industry. In November 2014, the Central Commission for Discipline Inspection (CCDI) concluded an inspection into state-owned FAW Group Corp, one of China's 'Big Four' automakers and a partner of Volkswagen AG, and its joint venture company with Volkswagen. According to media reports, the CCDI found ethics violations and evidence of corruption among the companies' executives, of whom at least two had been arrested during the course of the investigation. Penalty rulings against the executives are expected by April 2015. A similar investigation was initiated in December 2014 against Dongfeng Motor Co Ltd, a joint venture between China's state-owned Dongfeng Motor Corporation and Japanese carmaker Nissan Motor Co.

III YEAR IN REVIEW

i Recent deal activity

Going-private transactions

The trend of US-listed Chinese companies going private continued in 2014. During 2013, 18 US-listed going-private transactions were announced and eight were closed. During 2014, eight US-listed going private transactions were announced and 17 were closed.

Market research firms and short sellers such as Muddy Waters Research and Citron Research, building on their successes in 2012 and 2013, continued to target Chinese companies listed in the United States in 2014 by issuing critical research reports. Apparently, such firms have often simultaneously taken short positions in the Chinese companies they were covering, sometimes making substantial gains even if their accusations have not always been proven to be correct. Such accusations notably have not been limited to companies that listed through reverse takeovers (RTOs),[9] the usual suspects in the past. Similarly to the consequential criticism by Muddy Waters of Orient Paper Inc in 2010 and Sino-Forest Corp in 2011, the most notable case in

9 In an RTO, a private company merges with a publicly traded shell company and, as a result of the merger, the (formerly) private company becomes listed on the NYSE or Nasdaq without having paid the cost or fulfilled the burdensome disclosure requirements of an IPO.

2012 arose when, on 18 July, Muddy Waters published on its website a scathing report on the New Oriental Education & Technology Group Inc, sinking the company's share price by 35 per cent in one day. The stock price of New Oriental, apparently one of the more reputable and well-run companies that had undertaken a conventional IPO, subsequently recovered, suggesting that the accusations were not entirely justified. Similarly, on 24 October 2013, Muddy Waters published an 81-page report labelling Beijing-based mobile provider NQ Mobile Inc a 'massive fraud', sending the company's share price tumbling more than 60 per cent in three days. Since then, NQ's share price has also substantially recovered, but as in the New Oriental case, the fact that a single research report inflicted so much damage to a stock strongly suggests a widespread underlying lack of confidence in listed Chinese companies. The depressed valuation of many well-established companies has apparently played a key role in the three-year surge in going-private proposals.

As a consequence of continued pressure from the regulatory crackdown, negative press, short-selling activities and shareholder lawsuits, the stock prices of US-listed Chinese companies remained depressed through 2013 and 2014. The low valuations presented potential opportunities for management shareholders and private equity investors to privatise the US-listed companies, often with the aim of relisting them in other markets, for example, on the Chinese or Hong Kong stock exchanges, where the trading multiples for Chinese companies tend to be higher and market research coverage is seen as being more positive and understanding of the Chinese context. One of the significant going-private transactions announced and closed during 2014 was the acquisition of Giant Interactive by a consortium consisting of its chair, Shi Yuzhu, Baring Private Equity Asia, Hony Capital and CDH Investments valuing the formerly NYSE-listed company at approximately US$3 billion. This was the second-largest private equity-backed privatisation of a US-listed Chinese company (the largest being the take-private of Focus Media last year by the Carlyle Group, FountainVest Partners, CITIC Capital Partners, China Everbright Structured Investment Holdings and Fosun International at a value of approximately US$3.7 billion).

Unlike the early transactions in the trend of US-listed companies going private, some transactions executed in 2013 and 2014 went through more eventful processes, suggesting the increased challenges in completing such transactions in a more competitive deal-making environment with a shrinking pool of desirable targets. In the going-private transaction of NASDAQ-listed Yongye International Limited, the initial bid of the buyer consortium including Morgan Stanley Private Equity Asia and the company's CEO failed to receive requisite shareholders' approval in the first instance, and the transaction was approved in a later shareholder meeting after the buyer consortium raised the bid price by 6 per cent. In the going-private transaction of hospital operator Chindex International Inc, an initial offer of US$19.50 per share from the buyer group comprising Shanghai Fosun Pharmaceutical, TPG and the company's CEO was countered by a rival offer of US$23 per share received by the company in the 'go shop' period, and the buyer group eventually revised its offer to US$24 a share to secure the completion of the transaction, raising the total price tag to US$461 million.

The going-private trend was not limited to entities resulting from an RTO; four of the five significant Chinese companies that announced a going-private transaction in 2014, for example, were Cayman Islands or British Virgin Islands companies that accessed the public markets through a conventional IPO, compared with 11 Cayman Islands companies out of 14 China-based companies in 2013. Companies that list in the United States through a conventional offering may be appealing targets for a private equity investor given that, although their market valuations may have been materially reduced by the current investor mood disfavouring Chinese companies, they may be less likely to have the same types of accounting or securities law compliance problems as companies that became public through an RTO have had.

The large number of Chinese going-private transactions involving a Cayman-incorporated target have been driven in part by the introduction of new merger legislation in the Cayman Islands in April 2011, which contributed to making the statutory merger route within the Cayman Islands Companies Law an attractive means of effecting a going-private transaction. The merger process typically requires the buyer group to form a new Cayman Islands company that will merge with, and be subsumed by, the listed Cayman target. Under the 2011 amendments to the Cayman Islands Companies Law, the shareholder threshold for passing a statutory merger was reduced to a special shareholder resolution requiring only two-thirds (instead of 75 per cent) of the shareholders present at the meeting, absent any higher threshold in the articles of association of the target company. The lower merger approval threshold makes it an attractive acquisition option when compared with either a 'squeeze out' following a takeover offer or a scheme of arrangement, which would add time and cost arising from the court-driven process.

Most of the transactions that closed in 2014 took between three and four-and-a-half months to close (while the rest typically took six months or longer to close from the conclusion of definitive agreements) and were structured as a one-step, negotiated merger (as opposed to a two-step transaction consisting of a first-step tender offer followed by a second-step squeeze-out merger, which is the other basic approach to acquiring a US public company). In a one-step merger, a company incorporated in a US state will be subject to the US proxy rules, which require the company to file a proxy statement with the SEC and, once the proxy statement is cleared, to mail the definitive proxy statement to the shareholders and set a date for its shareholders' meeting. Transactions involving management retaining (either by themselves or with others) a controlling stake are 'going-private' transactions as defined under Rule 13e-3 of the Securities and Exchange Act, also commonly referred to as '13e-3 transactions'. A 13e-3 transaction requires making additional disclosures to the public shareholders, including as to the buyer's position on the fairness of the transaction. An important implication is that, whereas the SEC reviews only a fraction of all proxy statements, it routinely reviews 13e-3 transactions, which can lengthen the process by several months. Companies incorporated outside the United States that are listed on US stock exchanges (including the recent going-private targets that are incorporated in the Cayman Islands or the British Virgin Islands) are known as foreign private issuers (FPIs). FPIs are not subject to the proxy rules, but they are subject to 13e-3 disclosure obligations and are required to include as an exhibit to their 13e-3 filings most of the information that is required to be disclosed in a proxy statement by a US domestic issuer. Accordingly, both a transaction involving a US domestic company and a 13e-3 transaction involving an FPI follows a comparable timetable for purposes of SEC review.

Other notable transactions

Although the spotlight remained on going-private activity throughout the year, growth equity investments into Chinese technology companies were also noteworthy, including the US$1.1 billion funding round of Xiaomi Inc, the country's top-selling smartphone vendor founded in 2010, valuing the company at US$45 billion and led by All-Stars Investment Ltd (a recently established fund headed by former Morgan Stanley technology analyst Richard Ji) and including DST Global, GIC Pte, Hopu Investment Management and Yunfeng Capital (a private equity group affiliated with Alibaba's magnate Jack Ma). The high valuation reflects the growing interest and confidence among global investors to back China's innovative companies that have thrived in the domestic market with the potential and ambition for worldwide reach. Another example of a growth equity investment into a China technology company was the Series E financing round of Ganji, an operator of an online classifieds website, of more than US$200 million from both Tiger Global Management and the Carlyle Group, for an undisclosed valuation.

Another noteworthy theme of 2013–2014 was private equity investors' participation in the mixed ownership reform of China's state-owned enterprises (SOEs), where Chinese SOEs introduce private investors as minority shareholders. The highlight of this theme in 2014 was the US$2.4 billion acquisition of a 21 per cent equity interest in China Huarong Asset Management Co, Ltd, one of the largest asset management companies in China, by a consortium of investors including China Life Insurance (Group) Company, Warburg Pincus, CITIC Securities International Company Limited, Khazanah Nasional Berhad, China International Capital Corporation Limited, China National Cereals, Oils and Foodstuffs Corporation (COFCO), Fosun International Ltd and Goldman Sachs. Warburg Pincus was reported to have bought the largest portion of the 21 per cent stake for close to US$700 million.

ii Deal terms

Deal terms in going-private transactions

Most of the Chinese going-private transactions have involved all-cash consideration. Among the US-listed going-private transactions closed during 2014, the per-share acquisition price represented an average premium of 29 per cent over the trading price on the day before announcement of receiving the going-private proposal.

In a 13e-3 transaction, the board of directors of the target typically appoints a special committee of independent directors to evaluate and negotiate the transaction and make a recommendation. If the target is incorporated in the United States, the transaction almost inevitably will be subject to shareholders' lawsuits, including for claims of breaches of fiduciary duties, naming the target's directors as defendants. Because the target's independent directors often include US residents, a key driver of a transaction's terms is the concern for mitigating shareholders' litigation risk. While in 2013, no litigation claims for breach of fiduciary duties in a Chinese going-private transaction involving Cayman or British Virgin Islands companies were made public, it remains possible that, as the going-private trend persists, plaintiffs' firms will begin to articulate creative arguments in Cayman mergers and the Cayman courts may look to the body of Delaware law as persuasive precedent for adjudicating claims of breach of fiduciary duties. As a result, whether a going-private transaction involves a US or

Cayman-incorporated target, targets typically insist that certain key merger agreement terms (in addition to the deal process) be within the realm of what is 'market' for similar transactions in the United States.

An important negotiated term in many going-private transactions is the required threshold for shareholder approval. Delaware law requires that a merger be approved by shareholders owning a majority of the shares outstanding. Special committees often insist on a higher approval threshold, however, because under Delaware law, the burden of proving that a going-private transaction is 'entirely fair' to the unaffiliated shareholders shifts from the target directors to the complaining shareholders if the transaction is approved by a majority of the shareholders unaffiliated with the buyer group (i.e., the majority of the minority). In this type of US shareholder litigation, this burden shift is often seen as outcome determinative. Under Cayman law, there is no well-defined benefit for the company to insist on a higher approval threshold than the statutory requirement.

Another key negotiation point is whether the target would benefit from a go-shop period, which is a period following signing of a merger agreement during which the target can actively solicit competing bids from third parties. When defending against a claim of breach of fiduciary duty in Delaware, a company and its directors may point to a go-shop period in a merger agreement as a potentially helpful fact.

Deal terms in growth equity investments

Deal terms are more difficult to evaluate and synthesise in private transactions, where terms are not publicly disclosed. Generally, in the context of a growth equity investment (which, as we have seen, remains the dominant type of deal both by number of deals and by aggregate amount invested), private equity investors often continue to expect aggressively pro-buyer terms. This expectation applies whether a transaction involves an onshore Sino-foreign joint venture or an investment offshore alongside a Chinese partner. In a subscription agreement for a growth equity deal, an investor typically benefits from extensive representations and warranties against which the company makes only limited disclosures; in some cases, an investor has knowledge that some representations may not be accurate, but still insists on a representation to facilitate a potential indemnification claim later. It is not uncommon for an investor to also enjoy an indemnity provision with a cap on the amount of losses subject to indemnification as high as the purchase price (or no cap at all), no deductible or threshold and an unlimited survival period. Shareholders' agreements often contain similarly pro-investor terms, such as extensive veto rights (even in the case of a relatively small minority stake) and various types of affirmative covenants binding the company and its Chinese shareholders. If an investment is structured offshore (through, for example, a Cayman company that owns a Chinese subsidiary), a private equity investor may enjoy 'double-dip' economics pursuant to which, in the event of a liquidation or sale of the company, the investor is entitled to, first, a liquidation preference before any of the Chinese shareholders receive any proceeds, and second, such investor's *pro rata* share of the remaining proceeds based on the number of shares it owns on an as-converted basis. Because there is no well-defined 'market' when it comes to transaction terms in Chinese growth equity deals (unlike in going-private transactions), however, issuers also have opportunities to request, and sometimes obtain, terms that are very favourable to them. In Chinese growth equity investments, the parties' respective leverage and degree of sophistication are more likely to dictate the terms that will apply to a transaction than any market practice or standard. In more recent transactions, growth equity investments into high-growth technology companies have begun to contain less investor-friendly deal terms (e.g., new investors receiving *pari passu* liquidation preference with previous investors) as the competition by private equity firms to make investments into this sector continues to heat up.

For a private equity investor with sufficient commercial leverage, the key challenge often lies not in convincing the investee company or its Chinese shareholders to agree to adequate contractual terms, but rather in getting comfort that an enforceable remedy will be available in the event that the Chinese counterparty reneges on its contractual obligations. One potential antidote to the difficult enforcement environment onshore is to seek a means of enforcement offshore. An investor can get comfort if it obtains, for example, a personal guarantee of the Chinese founder backed by assets outside China, governed by New York or Hong Kong law and providing for arbitration in Hong Kong as a dispute resolution venue. Such a guarantee, however, is rarely available (because the Chinese founder may not have assets outside of China) and, even when potentially available, is often unacceptable to the founder. A more realistic alternative is for a private equity investor to seek the right to appoint a trusted nominee in a chief financial officer or similar position (who could monitor an investee company's financial dealings and compliance with its covenants to its shareholders). An investor may also seek co-signatory rights over the target company's bank account, in which case an independent third party (the bank) will ensure that funds are not released other than for purposes agreed by the investor.

iii Debt finance

Third-party debt financing continues to be available for acquisitions of Chinese companies by private equity investors. One key challenge, however, is that a Chinese target does not generally have the ability to give credit support (by way of guarantee or security over its assets) to a lender of offshore acquisition finance debt.

Many of the going-private transactions of US-listed Chinese companies involved debt financing, with the terms of the financings reflecting varying commercial and structural challenges. The acquisition debt was typically borrowed by an offshore acquisition vehicle with the borrower giving security over its assets (including shares in its offshore subsidiaries) to secure repayment of the debt. As was the case in 2011 and 2012, the typical lenders on these transactions spanned a wide range of financial institutions, from international investment banks to policy banks and offshore arms of other Chinese banks.

The *Focus Media* financing remains the standout transaction among the other debt-financed going-private transactions, due mainly to the size (US$1.52 million) and complexity of the debt financing facility and the large consortium of both major international banks (Bank of America Merrill Lynch, Citibank, Credit Suisse, DBS Bank, Deutsche Bank and UBS) and offshore arms of Chinese banks (China Development Bank, China Mingsheng and ICBC) that provided the financing. The *7 Days Inn* financing was another notable debt-financed going-private transaction that was largely financed by a syndicate of Asian banks (Cathay United Bank, China Development Industrial Bank, CTBC Bank, Entie Commercial Bank, Nomura, Ta Chong, Taipei Fubon Commercial

Bank, Bank of East Asia and Yuanta Commercial Bank). The debt financing for the *Giant Interactive* take-private was also underwritten and arranged by a large syndicate of banks, including China Minseng Banking Corp, BNP Paribas, Credit Suisse, Deutsche Bank, Goldman Sachs, ICBC International and JP Morgan in an aggregate amount of US$850 million. It can perhaps be considered as a positive signal for any future going-private transactions that such a large number of financiers were comfortable to commit to funding this type of event-driven financing. Another emerging theme in these offshore financing structures is that borrowers are seeking to access liquidity from the US debt markets in respect of what are essentially acquisitions of Chinese-based businesses – including as a means for a take-out for bridge financing originated out of Asia.

IV REGULATORY DEVELOPMENTS

i Potential amendment to the Foreign Investment Catalogue

On 4 November 2014, the NDRC and MOFCOM jointly issued a draft amendment to the Catalogue for the Guidance of Foreign Investment Industries for public consultation. The consultation period ended on 3 December 2014. As the Foreign Investment Catalogue is the principal policy in regulating the inflow of foreign investment in various domestic sectors, this consultation draft demonstrates the government's determination to further open up access to the market and sets the tone for the further reform of the foreign investment regulatory framework. If this consultation draft is eventually promulgated without further modifications, it will reduce the number of 'restricted' industrial sectors by more than half, abolish foreign ownership restrictions in certain sectors such as e-commerce and real estate development, and impose foreign ownership restrictions in certain sectors such as automobile manufacturing, medical institutions and education institutions.

ii Regulatory scheme for investment funds privately raised in China

On 22 August 2014, the China Securities Regulatory Commission issued the Interim Measures for the Supervision and Administration of Private Investment Funds, which became effective immediately. These rules apply to investment funds established by private fundraising in China as well as their fund managers. These rules require a fund manager to register, file certain fund information and make required disclosures with the Asset Management Association of China, which is a national fund industry self-regulatory association, and confirm that the offerings of interests in a private investment fund must be made privately in permitted manners to qualified investors under the criteria spelled out in these rules.

iii Streamlined process for MOFCOM antitrust filing and review

On 11 February 2014, MOFCOM issued the Interim Regulations on the Standards Applicable to Simple Cases of Concentrations of Undertakings, which became effective on 12 February 2014, and on 18 April 2014, MOFCOM issued the Guidelines on the Notification of Simple Cases of Concentrations of Undertakings (for Trial Implementation). These rules addressed the eligibility criteria of 'simple cases' and the procedure for the determination and filing of simple cases. Although these rules are silent on the precise timeline for a simplified process, they represent MOFCOM's effort toward a fast-track review practice. On 22 May 2014, MOFCOM published the first-ever 'simple case', i.e., Rolls-Royce Holding's proposed acquisition of the remaining 50 per cent interest in Rolls-Royce Power Systems, a joint venture between Rolls-Royce Holding and Daimler, which was classified as 'simple' because the joint venture will be controlled post-merger by an existing controlling shareholder.

On 6 June 2014, MOFCOM issued the revised Guiding Opinions on the Notification of Concentrations of Undertakings for investors' reference to facilitate their awareness and determination of an antitrust filing. These opinions clarify the concept of 'control' and deciding factors, turnover calculations and pre-filing consultation procedures.

On 4 December 2014, MOFCOM issued the Provisions on Imposing Restrictive Conditions on Concentration of Undertakings (for Trial Implementation), which became effective on 5 January 2015. These provisions specify three types of remedies MOFCOM may impose on a transaction that is subject to MOFCOM's antitrust review: structural conditions such as divestitures of tangible assets and intangible assets (including intellectual property) and related interests; behavioural conditions such as opening up a network, platform or other infrastructure, licensing key technologies (including patents, know-how and other intellectual property), and terminating exclusive agreements; and a combination of structural and behavioural conditions. Penalties for non-compliance include MOFCOM's enforcement orders requiring rectification of non-compliance or unwinding of a transaction; and a monetary fine up to 500,000 renminbi.

iv Recent State Administration of Foreign Exchange (SAFE) circulars to facilitate cross-border financings

On 10 January 2014, SAFE issued Circular No. 2 [2014] on Further Improving and Adjusting the Foreign Exchange Policies on Capital Account Items (Circular 2), which became effective on 10 February 2014. Subject to registration with the local SAFE branch, Circular 2 allows an onshore company to lend to its offshore affiliates if the loan amount does not exceed 30 per cent of the onshore lender's shareholder's equity. A loan exceeding such threshold requires SAFE approval on a case-by-case basis.

On 12 May 2014, SAFE issued Circular No. 29 [2014] on Provisions on Foreign Exchange Administration of Cross-Border Guarantee and Security (Circular 29), which became effective on 1 June 2014. Circular 29 makes available cross-border security taken in certain forms that, *inter alia*, lifts the ban on upstream guarantees provided by an onshore operating subsidiary to its offshore parent, except for guaranteeing the offshore parent's offshore bond issuances; and permits cross-border asset mortgages, subject to the applicable registrations with the relevant governmental agencies.

On 4 July 2014, SAFE issued Circular No. 37 [2014] on Issues Relating to the Administration of Foreign Exchange in Respect of Offshore Investments, Financings and Round-trip Investments by Domestic Residents through Special Purpose Vehicles (SPVs) (Circular 37), which became effective immediately and superseded and repealed the precedent similar regulation (Circular No. 75 [2005]). Circular 37 clarifies and simplifies certain SAFE registration requirements, including, *inter alia*:

a expanding the scope of SPVs to include offshore vehicles formed by Chinese residents utilising offshore assets;

b including onshore greenfield investments as a way of round-trip investment;
c permitting Chinese employees to register an equity incentive of an offshore unlisted SPV before the exercise of the granted equity incentive;
d allowing a domestic company that is directly or indirectly controlled by a domestic resident to lend to an offshore SPV formed by such domestic resident; and
e removing the 180-day time frame for the repatriation of offshore profits.

The adoption of these circulars has been widely praised as an improvement in SAFE's evolving oversight of cross-border capital transactions, and reflect SAFE's efforts to overhaul its regulatory approaches to support China's 'going global' strategy.

v Loosening the regime for outbound investments

Ordinarily, Chinese outbound investments are subject to various interactions with certain Chinese regulatory agencies, primarily with the NDRC and MOFCOM or their local counterparts.

On 8 April 2014, the NDRC issued the Measures on the Approval of and Filing for Outbound Investment Projects, which became effective on 8 May 2014 and was later amended by the NDRCC on 27 December 2014. Under these new NDRC measures, Chinese outbound investments involving sensitive countries or regions or industries must be approved by the central NDRC, and an approval by the State Council will be required if the size of an investment with such sensitive factor reaches or exceeds US$2 billion; and Chinese outbound investments that do not involve sensitive countries or regions or industries will be subject to a simplified filing process, and a filing with the central NDRC will be required if the Chinese investor is a central-level SOE or if the size of the Chinese investment reaches or exceeds US$300 million.

On 6 September 2014, MOFCOM issued the Measures for Outbound Investment Administrations, which became effective on 6 October 2014. Under these new MOFCOM measures, other than investments in sensitive countries or regions or industries, Chinese outbound investments will be subject to a simplified filing process with MOFCOM (if the Chinese investor is a central-level SOE) or its provincial counterpart.

V OUTLOOK

In light of increased scrutiny by both US and China regulators, foreign private equity investors in China continue to increase their focus on rigorous pre-transaction anti-corruption due diligence, taking steps to ensure that any improper conduct has ceased prior to closing and implementing robust compliance policies after closing. In high-risk circumstances, such as transactions involving companies where significant government interactions are necessary for their operations, the process can be complex and expensive.

As the Chinese economy continues to rebound and to be positioned for slower but steady growth following the global financial crisis and uncertainties created by a change in leadership, most commentators expect private equity investments, as well as IPOs and other exits, which resumed their growth in the latter part of 2014, to continue growing into 2015. However, as the volume and assets under management of domestic Chinese private equity funds continue to grow, foreign private equity firms focused on China face more competition to win deals and obtain favourable terms and valuations, especially in high-growth areas such as technology and health care. In addition, issuers based in China have become more sophisticated in their negotiation of deal terms, which also results in terms that are not as investor-friendly as private equity investors may have been able to obtain in previous years.

Although the volume of take-privates of Chinese companies listed in the US appeared to have plateaued as fewer attractive targets remain, it appears that there may be increased attention on take-privates of Chinese companies listed on the Hong Kong stock exchange. Two remarkable transactions heading this trend are Blackstone's US$322.6 million takeover of property and construction group Tysan Holdings, which was launched in August 2013, and Carlyle's take-private of Asia Satellite Telecommunications Holdings Ltd, where Carlyle agreed to buy out General Electric's 74 per cent stake in the company for up to US$483 million and launched a tender offer for the company's remaining shares in December 2014.

Chapter 24

UNITED STATES

Norbert B Knapke II[1]

I OVERVIEW

i Deal activity

2014 was a very good year for US private equity sponsors. Private equity firms closed more US deals and deployed more capital in 2014 than they did in 2013, even as the number of large transactions declined. The past year also proved to be one of the best for monetising private equity investments in a decade, exceeding even 2012's record numbers, with robust markets for both merger and acquisition (M&A) and initial public offering (IPO) exits. While the overall credit market contracted, M&A financing volume was at its highest level since 2007.

Buyouts

Private equity sponsors completed 6 per cent more US buyout transactions in 2014 than 2013, although the total amount invested was up only slightly, reflecting a decline in mega deals and an explosion of middle-market transactions. The total value of $100 million to $1 billion buyouts increased 58 per cent over 2013's levels.[2] Not only did fewer multi-billion dollar deals close in 2014, those deals were also much smaller than 2013's mega-deals: 2014's largest buyout, the $5.4 billion acquisition of Gates Global by Starr Investments, was about one-fifth the size of the $24.9 billion Dell buyout in 2013.

The number of US buyouts completed in 2014 lagged behind 2012's numbers (by almost 5 per cent), although the aggregate amount invested was much greater (by about 33 per cent).[3] Not surprisingly, the 2014 buyout market was much smaller than in

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2 Source: Pitchbook, *PE Breakdown: 2014 Annual Report*.

3 Id.

2007, when private equity firms completed more than 1.2 times as many deals with an aggregate deal value nearly 2.6 times than in 2014.

Add-on transactions (i.e., acquisitions by private equity portfolio companies) increased their share of US buyouts, accounting for 60 per cent of 2014 transactions, up from a 58 per cent share in 2013, a 53 per cent share in 2011 and a 44 per cent share in 2007.[4]

A 2014 bull market in US stocks along with active strategic buyers led to a sharp decline in private equity sponsor-led take-private transactions, with the number and aggregate value of such deals down 50 per cent from 2013 levels. There were also fewer (by 47 per cent) sponsor-led take-privates in 2014 compared with 2012, although the aggregate value of such deals was substantially higher in 2014 (by almost 70 per cent).[5] As expected, 2014 numbers pale in comparison with 2007, which had almost 4.2 times as many take-private deals, with an aggregate value about 7.8 times greater.[6]

Growth equity

In 2014 private equity firms found many more opportunities for US growth equity investments (i.e., purchasing a minority equity stake in a mature firm) than in 2013, with the total number of deals up about 24 per cent, and the average reported value also up by about 24 per cent. The number of 2014 growth equity investments was significantly higher than in 2012 (by about 31 per cent), but with the average reported deal size essentially the same. Unlike with buyouts, private equity firms completed many more US growth equity investments in 2014 than in 2007, although the average reported deal size was smaller.[7]

Exits

In 2014, the pace of US private equity exits accelerated, eclipsing 2013's activity by 10 per cent by deal count and 37 per cent by value.[8] The 2014 US market for private equity exits also exceeded 2012's record, and largely tax-driven levels – although the number of 2014 exits lagged behind 2012 levels (by less than 1 per cent), the value of returned capital increased by nearly 18 per cent.[9]

Active strategic buyers and continued sponsor-to-sponsor buyout activity made 2014 the best year for M&A exits in a decade. In April, a group including Blackstone, KKR and TPG sold medical device manufacturer Biomet to Zimmer Holdings for a reported $13.4 billion, while a group including aPriori Capital Partners, Citi Private Equity and Madison Dearborn Partners sold Nuveen Investments to TIAA-CREF for a reported $6.3 billion. In May, the Carlyle Group sold Beats By Dre to Apple for a

4 Id.

5 Source: FactSet Mergers.

6 Id.

7 Source: Prequin. 2012 growth equity transactions included two $1 billion-plus investments in energy companies.

8 Source: Pitchbook (see footnote 2).

9 Id.

reported $2.5 billion. In September, the Apollo Group sold Athlon Energy to Encana Corporation for a reported $7 billion, and Prestige Cruises to Norwegian Cruise Line for a reported $3 billion. Finally, in November, Madison Dearborn and DE Shaw sold First Wind Holdings to Sun Edison for a reported $2.4 billion.[10]

The 2014 IPO market was strong as well, with 69 PE-backed firms completing IPOs, exceeding 2013's record number (64 IPOs), although the aggregate value of IPO exits fell by 8 per cent (in part due to several very large IPOs in 2013).[11] Portfolio companies in a wide range of industries, including financial services (Ally Financial and Santander Consumer), health care (IMS Health), manufacturing (Axalta Coating Systems) and hotels (La Quinta), tapped the public markets.[12]

The market for secondary buyouts (i.e., sponsor-to-sponsor transactions) changed course in 2014 and rose as a share of the number of exits (from 41 per cent in 2013 to 44 per cent in 2014), but fell as a share of the total value of M&A exits (from 39 per cent in 2013 to 29 per cent in 2014).

Looking ahead, the market for IPOs, corporate acquisitions and secondary buyouts will become increasingly important for private equity firms looking to liquidate their still-large inventory of portfolio companies (about 7,700). However, private equity firms have made significant progress in reducing their inventory of portfolio companies acquired before 2008, and the increased pace of exits when compared with investments has reduced sponsors' investment-to-exit ratio to its lowest level in a decade.[13]

Financing

The overall volume of US debt financing contracted in 2014 when compared with 2013's records, but M&A lending had its best year since 2007. According to S&P Capital IQ, leveraged lending in 2014 was down 12.7 per cent compared with 2013, with overall M&A financing up 43 per cent – in 2014, M&A lending comprised 48 per cent of the total market, as compared with only 32 per cent in 2013. However, lending to private equity sponsors (for all purposes, including M&A, refinancing and dividend recaps) declined by 10 per cent,[14] largely driven by a 10 per cent decline in the value of loans to portfolio companies to finance dividends or stock repurchases. High-yield bond issuances fell slightly in 2014 – about 2 per cent – from the record set in 2013,[15] but the 2014 volume of second-lien loans (i.e., loans with a security interest subordinate to the lien securing traditional bank debt) grew by more than 25 per cent over 2013's record.[16] 'Covenant-lite' loans (i.e., loans with minimal financial maintenance covenants) continued to be popular, with the number new issuances up almost 12 per cent, although

10 Source: Prequin (see footnote 7).

11 Source: Pitchbook (see footnote 2).

12 Source: Prequin (see footnote 7).

13 Source: Pitchbook, *Q4 2013 Private Equity Company Inventory Report*.

14 Source: S&P/Capital IQ, *LCD's Leveraged Lending Review – 4Q14*.

15 Source: Thomson Reuters, *4Q14 Review and 1Q15 Preview*.

16 Source: S&P/Capital IQ (see footnote 14).

the aggregate principal amount of new convenant-lite loans declined by almost 9 per cent.[17]

The 2014 market saw continued expansion of overall debt multiple levels, as well as an increase in equity contribution amounts. Debt multiples for large corporate leveraged buyouts (LBOs) (defined as issuers with more than $50 million in EBITDA (earnings before interest, taxes, depreciation and amortisation)) averaged 5.8 times EBITDA in 2014 compared with 5.4 times EBITDA in 2013, while leverage for middle-market LBOs (issuers with less than $50 million EBITDA) averaged five times EBITDA, compared with 4.8 times EBITDA in 2013.[18] At the same time, the average amount of sponsors' equity contributions increased from 37 per cent of total capitalisation in 2013 to 39 per cent in 2014.[19] Data from 4Q 2014 suggest pro-borrower trends will moderate in 2015: fourth quarter equity contribution levels were higher than the full-year average (42 per cent), and Q4's average leverage declined for both large LBOs (to 5.6 times EBITDA) and middle-market loans (to 4.8 times EBTIDA).[20]

In late 2013, the Board of Governors of the Federal Reserve System (Fed),[21] the Office of the Comptroller of the Currency (OCC)[22] and the Federal Deposit Insurance Corporation (FDIC),[23] the main US banking regulators, issued guidance intended to improve leveraged lending underwriting standards among financial institutions under their jurisdiction, and to reduce overall systemic risk believed to be caused by weak leveraged lending practices. After reviewing the financial institutions' compliance with the original guidelines, in 2014 the agencies published additional guidance indicating that they would initiate monthly monitoring focusing on four leveraged lending parameters:

a the borrower's leverage, with concerns raised by total debt-to-EBITDA ratios in excess of six times;

b whether the borrower has the ability to repay its debt over the medium term (e.g., five to seven years) from free cash flow;

c whether the loan agreements contain adequate covenant protections; and

d whether the loan agreements allow for the material dilution, sale or exchange of collateral or cash flow without lender approval.

It is unclear what effect the leverage lending guidance will have on the US debt markets. It does not cover bond issuances or unregulated, non-traditional lenders (e.g., private equity firm credit affiliates, Jefferies Finance, Nomura Holdings), and is not an absolute

17 Id.

18 Id.

19 Id.

20 Id.

21 The Fed generally oversees the US operations of foreign banks (e.g., Banco Santander, Barclays and UBS) and US bank holding companies (e.g., General Electric Capital Corporation, Citigroup and Goldman Sachs).

22 The OCC generally regulates national banks such as Bank of America, JPMorgan Chase and Wells Fargo.

23 The FDIC (among other things) insures deposits at US depository banks.

prohibition against lending into a deal that pushes the boundaries of the four parameters. On the other hand, anecdotal evidence exists of regulated lenders shying away from such loans, particularly if the leverage exceeds 6 times EBTIDA. In addition, some market observers expect fewer leveraged recap and dividend transactions in 2015, in part as a result of the impact of the leveraged lending guidance.

ii Operation of the market

The US market for corporate control is very efficient. Many private targets are sold through an auction run by investment bankers or similar intermediaries. While a smaller proportion of public targets are sold through a full-blown auction, the legal framework (in general) attempts to duplicate an auction by encouraging a target's board of directors to follow a process designed to secure the highest reasonably attainable price for stockholders.

Public targets

From a legal point of view, the US market for sponsor-led going-private transactions is driven primarily by the following considerations:

a the fiduciary obligations of the target's board of directors as defined by the laws of the target's state of incorporation (most frequently, Delaware);

b financing risks; and

c the rules of the Securities and Exchange Commission (SEC) regarding tender offers or proxy solicitations.

Each of these factors influences not only the time required to purchase a US public target but also the transaction's structure.

Delaware courts have held that when a target's board decides to sell the company it must satisfy what are known as *Revlon* duties.[24] *Revlon* requires a contextually specific application of the board's normal duties of care and loyalty designed to ensure that it conducts a process to seek and attain the best value reasonably available to the target's stockholders. There is no single, court-prescribed course of action for a board to follow (e.g., conducting a pre-signing auction for the target or always using a special committee of disinterested directors to negotiate with a suitor). However, certain conventions – such as fiduciary outs and limits on termination fees and other deal protections – have arisen in response to guidance from Delaware courts to balance the target board's obligation under *Revlon* and the bidder's desire to obtain deal certainty.

Since the private equity-led going-private market came back to life after the 2008 financial crisis, many deals have featured the 'go-shop' exception to a target's

24 *Revlon v. McAndrews & Forbes Holdings, Inc* (Del Sup Ct 1986). Many states do not follow *Revlon*; some states, such as Indiana (Indiana Code Section 23-1-35-1(d)), Pennsylvania (Pennsylvania Business Corporations Law Section 1715) and Wisconsin (Wisconsin Business Corporations Law Section 180.0827), have constituency statutes permitting directors to consider not only price but also other stakeholders' interests, such as the target's employees, suppliers and communities in which the target operates, when considering a sale.

customary 'no-shop' covenant.[25] In a typical go-shop, the target is given a window – usually 25 to 40 days – to actively seek a superior offer. If a qualifying topping bid emerges during the go-shop period, the target may terminate its agreement with the original acquirer by paying a reduced termination fee and enter into a new agreement with the higher bidder. Most importantly, from a private equity bidder's perspective, Delaware courts have concluded that a target board that does not conduct a pre-signing auction or market check can satisfy its *Revlon* duties by including a go-shop in the merger agreement, so long as the rest of the process and other deal protections are satisfactory.[26]

The go-shop structure allows a private equity buyer to approach a desirable take-private target board and, if the parties can agree on a fair price, conduct confirmatory due diligence and finalise the terms and conditions of the transaction – including a go-shop – quickly and privately. As long as the other facts and circumstances of the process pass *Revlon* muster,[27] this approach allows target directors to satisfy their duties, while avoiding a time-consuming, uncertain and potentially damaging public auction.[28] In exchange, the private equity bidder accepts the risk that the target may find a topping bid during the go-shop period – an unusual occurrence, according to the FactSet Mergers database.[29]

Parties to a US leveraged take-private must contend with the risk that debt financing may not be available at closing. Unlike some other countries (e.g., the United Kingdom), 'certain funds' (i.e., a fully negotiated and executed credit agreement between a buyer and its lenders delivered at deal announcement) is neither required nor available in the US, and financing commitment letters, no matter how 'tight' (i.e., lacking in pre-conditions) cannot be specifically enforced even if the providers of such letters have clearly breached their terms. In response, dealmakers have crafted a model that has become the most common (but by no means the sole) way to allocate the risk of financing failure.

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25 A 'no shop' covenant prohibits the target from actively seeking an acquisition proposal, but typically allows a target to respond to an unsolicited proposal that could be reasonably be expected to lead to a better transaction for target stockholders.

26 See, e.g., *In re Topps C S'holder Litigation* (Del Ch 2007) and *In re Lear Corp S'holder Litigation* (Del Ch 2007). There are many dimensions to a go-shop's terms, such as the length of the go-shop period, the size of the reduced fee and limitations on what constitutes a superior offer, each of which is taken into account when evaluating the board's compliance with *Revlon*.

27 For an example of a transaction in which Delaware courts questioned the target board's process, see *In re Del Monte Foods S'holders Litigation* (Del Ch 2011).

28 The inherent flexibility of *Revlon* allows dealmakers to craft creative solutions to meet the needs of any particular transaction. For example, see Ginsburg, Levin and Rocap, *Mergers, Acquisitions, and Buyouts – Transactional Analysis* (Wolters Kluwer, September 2014), Section 1702.11.5, for a description of a hybrid no-shop/go-shop provision.

29 Of the deals in FactSet's database (dating back to 2003), 238 had a go-shop, only 26 of which were 'jumped'.

This model generally allows a target to obtain, as its sole pre-termination remedy, an order from a court, known as an order for 'specific performance', forcing a buyer sponsor to make good on its commitment to provide the necessary equity financing and to complete the merger if, and only if, all of the conditions to the merger are satisfied, the debt financing is available for closing and the target agrees to close when the equity is funded. If, on the other hand, the target chooses to terminate the merger agreement, either because the private equity sponsor is unable to close because the necessary debt financing is not available or otherwise breaches the agreement, then the sponsor must pay the target a reverse break-up fee (usually an amount greater than the target's termination fee) and the transaction is terminated. Payment of the reverse break-up fee is the target's sole and exclusive remedy against the sponsor and its financing sources, even in the case of a wilful breach.[30]

Parties to a sponsor-led take-private transaction add yet another level of complexity when they choose to proceed via a two-step tender offer (rather than a one-step merger). In a tender offer, the sponsor offers to purchase the shares of the target directly from the stockholders, obviating the need – at least in the initial step – for a stockholder vote. The sponsor's obligation to complete the tender offer is typically conditioned upon stockholders tendering more than 50 per cent of the outstanding shares. If this 'minimum tender' condition is satisfied, the sponsor must acquire all untendered shares in a 'back-end' merger, the terms of which are set out in a merger agreement executed by the target and buyer on the day they announce the tender offer. Depending on the circumstances of the deal, including the target's state of incorporation, the 'back-end' merger can be completed immediately after the closing of the tender offer; otherwise the buyer must engage in a long (three to four-month) and expensive proxy solicitation process and hold a target stockholders' meeting before it can complete the back-end merger.

Failure to acquire all of the outstanding stock on the same day the tender offer closes makes it much more difficult to use debt financing due to the application of US margin stock rules, a highly complex set of laws and regulations that, in general, prohibit any person from financing the acquisition of US public company stock with more than 50 per cent debt financing secured by the target's stock or assets. Many sponsor-led US take-private transactions are more than 50 per cent leveraged, so parties to such transactions must find solutions that satisfy the margin rules if they wish to enjoy the benefits of a tender offer.

The easiest way to avoid a delayed back-end merger is for the buyer to acquire in the tender offer a supermajority of the target's shares – in Delaware, 90 per cent – allowing the buyer to complete a 'short form' merger immediately after closing the tender offer. By completing the back-end merger essentially simultaneously with the offer, a sponsor can more easily structure its debt financing to comply with the margin

30 Not all deals follow this model. In some deals, sponsors have assumed all of the financing risk and granted the target full specific performance; on the other, rarer end of the spectrum, buyers have agreed to a two-tiered reverse break-up fee, with a smaller fee payable if debt financing is unavailable, and a larger fee payable if the sponsor breaches its obligation to close (even if debt financing is available).

rules and lender demands for a lien on the target's assets. In most deals, however, it is not realistic to expect stockholders to tender such a large proportion of the outstanding shares.

In response, dealmakers have created two innovative techniques to avoid the potential delays of a full-blown back-end merger process and the complications presented by the margin rules: the top-up option, and the dual-track or 'Burger King' structure. In addition, in August 2013 Delaware – by far the most common state of incorporation for US listed companies – enacted Delaware General Corporation Law Section 251(h), giving dealmakers yet another way to close a tender offer and back-end merger on the same day. The adoption of Section 251(h) has rendered the Burger King structure[31] essentially obsolete, at least for a Delaware target, but dealmakers continue to utilise the top-up option, often in conjunction with Section 251(h).

Top-up option

In a top-up option the target agrees, upon completion of the tender offer, to issue to the buyer a sufficient number of its authorised but unissued shares to allow the buyer to reach the threshold required for a short-form, back-end merger. Delaware courts have approved the top-up option structure, with a few easily satisfied caveats,[32] largely because it puts money in stockholders' hands more quickly without harming their interests. The primary limitation of the top-up option is mathematical: the number of shares required to hit 90 per cent may be very large because the calculation is iterative, so it is often the case that a target does not have enough authorised but unissued shares in its constituent documents to utilise the top-up option.

Section 251(h)

Section 251(h) eliminates, subject to certain conditions, the requirement for stockholder approval of a back-end merger after a tender offer for a listed company or one with more than 2,000 stockholders of record if the buyer acquires more than the number of shares required to approve a merger (typically a bare majority, but it could be more if the target's certificate of incorporation so requires) but less than the 90 per cent threshold for a short-form merger.

Section 251(h) is an important and useful innovation, as it allows the buyer to acquire all of the outstanding shares and the non-tendering stockholders to receive the

31 Parties would choose a Burger King structure if the target did not have sufficient authorised but unissued shares to have both a top-up option and a 50 per cent minimum tender condition. In such a structure, the parties agree to the lowest minimum tender condition possible given the number of its authorised but unissued shares, (e.g., 70 per cent), and agree to 'flip' to a traditional one-step merger if the chosen minimum tender condition will not be satisfied.

32 See *Olson v. ev3, Inc* (Del Ch 2011). The buyer must pay cash for at least the par value of the issued shares (with the remainder purchased with a demand note, the terms and conditions of which were approved by the target's board), and the top-up option shares must be ignored if any dissenting stockholder elects to seek an appraisal of its shares.

merger consideration without the lost time and expense of a three to four-month proxy solicitation process.[33] Section 251(h) is not a perfect solution for private equity buyers, however. Sponsors often give target management or other significant target stockholders the opportunity to exchange all or a portion of their target stock for buyer stock, which can run afoul of the condition in Section 251(h) that all target stockholders receive the same consideration in the transaction. As a result, many deals still utilise a top-up option, either in lieu of or as a backup in the event the Section 251(h) conditions cannot be satisfied.[34]

Private targets

Because it is easier to maintain confidentiality and the consequences of a failed auction are less dire, a full-blown auction for a US private target is more common than for a public target. In an auction for a US private target, the target's advisers typically invite several bidders to conduct limited due diligence and submit indicative bids, with the highest and most credible bidders invited to conduct further due diligence and submit additional bids. The time required to sell a private target can vary considerably: an auction and sale process for a desirable private target can take, from start to finish, as little as two months, while other processes may take many months. If the buyer requires debt financing, the health of the debt markets also affects the length of the process.[35]

In an auction a private equity firm must compete not only on price but also on terms, timing and attractiveness to management. While in the past private equity bidders often conditioned their bids on receiving necessary debt financing, in today's market such a condition likely will adversely affect the competitiveness of a bid, particularly in a larger deal. Indeed, in the current market many private-target acquisition agreements (a clear majority in larger deals) contain the same conditional specific performance and reverse break fee mechanism now common in take-private transactions.

The US buyout market has also seen continued growth in the use of commercial insurance policies intended to protect buyers or sellers (or both) against various transaction-related risks, such as breaches of representations and warranties. These insurance products often allow parties to bypass difficult negotiation over post-closing indemnification by shifting specified transaction risks to a sophisticated third party in the business of taking such risks. An increasing number of private equity firms have

33 In 2014 the Delaware legislature amended Section 251(h) to eliminate the 'no interested stockholder' condition in the original statute, which essentially prohibited acquirers from entering into support agreements with target stockholders, a common feature of private equity sponsor take-privates.

34 In addition, top-up options and the Burger King structure may still be used if the target is not incorporated in Delaware and the applicable state law does not have a Section 251(h) analogue.

35 While in theory *Revlon* and related principles of Delaware law apply equally to the sale of a private target as to a public target, in practice a buyer often deals directly with target stockholders (or at least controlling stockholders), minimising or even eliminating the board of directors' role and the related legal issues.

successfully used M&A insurance to either make their bids more attractive to sellers or limit their post-closing liabilities when exiting an investment.

Management equity

Management equity practices vary across US private equity firms, but certain themes are common:

a executives with sufficient net worth are expected to invest side-by-side with the sponsor to ensure they have sufficient 'skin in the game';

b management equity entitles the holder only to modest stockholder rights – in some cases, only the right to be paid in connection with a distribution or liquidation;

c holders of management equity get liquidity when and to the same extent that the sponsor gets liquidity; and

d incentive equity (and at times part or all of management's co-invested equity as well) is subject to vesting, whether upon passage of time, achievement of various performance goals, or a combination of the two.

The size of the management incentive equity pool generally ranges from 5 to 15 per cent, with smaller deals generally congregating at the upper end of the range, and larger deals generally at the lower end.

The prospect of participating in a potentially lucrative incentive equity pool can be powerful motivation for management to prefer a private equity buyer over a strategic buyer unlikely to offer a similar plan (and who might fire management instead). A private equity bidder for a private target can use this to its advantage, particularly when management cooperation is key to a successful sale. When pursuing a public target, however, such a strategy carries additional risk, as Delaware courts, the SEC and the market are sensitive to the conflict of interest presented when a target officer – particularly the CEO – has a personal incentive to prefer one bidder over another.

For this reason, the board of a public target often instructs its management not to enter into an agreement with a private equity suitor regarding compensation or equity participation before the stockholders have voted on the deal (or tendered their shares to the buyer). Indeed, it is often in a private equity buyer's interest not enter into an agreement with management before the stockholder vote, because the SEC (by way of its Rule 13e-3) requires substantial additional disclosure in such situations. In addition, management participation in a transaction prior to a stockholder vote may increase the risk (and potentially cost) of stockholder lawsuits opposing the deal.

II LEGAL FRAMEWORK

i Acquisition of control and minority interests

The US federal system – in which the federal (i.e., national) government exercises supreme authority over a limited range of issues, and the individual states exercise authority over everything else occurring within their respective jurisdictions, with overlaps seemingly everywhere – presents private equity firms with a complex legal maze to navigate when acquiring control of or investing in the equity of a target company. A private equity firm contemplating an investment in the US confronts the following regulatory regimes:

a federal securities laws and regulations, administered by the SEC;[36]

b state corporation law (usually the Delaware General Corporation Law), alternative business entity law (usually the Delaware Limited Liability Company Act or the Delaware Limited Partnership Act) and securities laws (called 'Blue Sky' laws);

c federal, state, local and foreign tax laws and regulations;[37]

d Hart-Scott Rodino Antitrust Improvements Act (HSR Act) pre-merger antitrust review;

e particularly when making a minority investment in a public target, the rules of the stock exchange where the target's shares are listed, such as the New York Stock Exchange or the Nasdaq National Market;

f potential review by the Committee on Foreign Investment in the US of an investment by a non-US investor in a US target, if the investment threatens to impair national security;[38] and

g industry-specific regulatory schemes – such as those found in the energy, pharmaceutical, medical device and telecommunication industries – that may require advance notification to or even approval by a governmental authority.

The first three regulatory schemes – federal securities laws, state corporate and securities laws, and tax – affect every investment a private equity firm may make in the United States. The HSR Act applies only if a deal exceeds specified levels,[39] and the applicability of the others depends on the nature of the target and, in some cases, the characteristics of the buyer as well.

In general, neither US federal securities laws and regulations nor Delaware corporate and other business entity laws focus upon the substance of a transaction. Rather, the federal scheme is designed to ensure that parties to the transaction – whether a direct sale of stock, a merger, a tender offer or issuance of shares – receive adequate disclosure, and in some cases adequate time to make a fully informed investment decision, and Delaware law is chiefly concerned with the process followed by the company's governing body when considering the transaction.

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36 In April 2012, the JOBS Act became law. The JOBS Act contains a number of changes to US federal securities laws and regulations, most of which are intended to make it easier for small businesses to raise capital. While the JOBS Act is expected to benefit US private equity fundraising, it likely will have little impact on US private equity transactions.

37 The tax implications of any private equity transaction are tremendously complex. For a thorough discussion of such issues, see generally Ginsburg, Levin and Rocap (footnote 28).

38 See Laura L Fraedrich and Daniel J Gerkin, 'Treasury Proposes Regulations Implementing Foreign Investment and National Security Act', Kirkland *Private Equity Newsletter* (13 June 2008), available at www.kirkland.com/siteFiles/Publications/3ED260166BA840000799E25258839EF4.pdf.

39 See Kirkland *Alert* (January 2015) for the most recent HSR filing thresholds, available at www.kirkland.com/siteFiles/Publications/Alert_012115.pdf.

ii Fiduciary duties and liabilities

Corporations

In general, stockholders of a Delaware[40] corporation do not owe any duty, fiduciary or otherwise, to one another. Thus, a private equity firm is free to act in its own interest, subject to very limited exceptions,[41] when deciding to vote or sell its portfolio company stock, subject to contractual rights (e.g., tag-along or registration rights) of the company's other stockholders. On the other hand, a controlling stockholder may be liable to the corporation or its minority stockholders if the controlling stockholder enters into a self-interested transaction with the corporation at the expense of the minority.[42]

All directors (and officers) of a Delaware corporation, including sponsor representatives on the board, owe the corporation and its stockholders the following duties:

a a duty of care, requiring a director to be reasonably informed and to exercise the level of care of an ordinarily prudent person in similar circumstances;

b a duty of loyalty, requiring a director to act in the interests of the corporation and its stockholders and not in his or her own interest; and

c a duty of good faith, or perhaps better stated a duty not to act in bad faith, often described as the intentional or reckless failure to act in the face of a known duty, or demonstrating a conscious disregard for one's duties.

Subject to limited exceptions, when reviewing the conduct of a corporation's directors Delaware courts will apply what is known as the 'business judgement rule,' which presumes that a director acted with reasonable care, on an informed basis, in good faith and in the best interest of stockholders, and not second-guess the director's decisions. Only if a plaintiff proves that a director made an uninformed decision or approved a self-interested transaction will the courts apply the 'entire fairness' doctrine and require the director to prove that the price and the process leading to the disputed transaction were fair to the corporation and its stockholders. In addition, when reviewing certain transactions, such as the imposition of defensive measures (e.g., a poison pill) or the sale of control (see the *Revlon* discussion, above), Delaware courts apply what has come to be known as 'enhanced scrutiny,' a standard more rigorous than the business judgement rule but less than entire fairness, in which the court reviews the adequacy of the process leading to the challenged transaction and whether the price was reasonable.

Delaware law also allows a corporation to exculpate its directors (but not officers) from monetary liability for a breach of the duty of care,[43] and to indemnify its directors and officers against claims and expenses arising out of the performance of their board

40 This section deals only with the laws of Delaware. The laws of other states may be materially different.

41 See e.g., *Abraham v. Emerson Radio Corp* (Del Ch 2006).

42 See e.g., *In re Loral Space and Communications Inc* (Del Ch 2008).

43 Delaware General Corporation Law Section 102(b)(7).

duties.[44] Such exculpation and indemnification are not available, however, for any director or officer found to have breached the duty of loyalty.

A sponsor representative on the board of a Delaware corporation must also be aware of the corporate opportunity doctrine, under which a corporate officer or director must offer the corporation any business opportunity that the corporation is financially able to undertake, that is within the corporation's line of business and with respect to which the corporation has an interest. The corporate opportunity doctrine can cause a problem for a sponsor owning or expecting to invest in a competing or similar business, but it can be disclaimed if appropriate language is included in a company's articles of incorporation.

If a Delaware corporation has preferred and common stock, its board owes its duties only to the common stockholders if there is conflict between their interests and those of the preferred stockholders.[45] If a corporation is insolvent (or in bankruptcy), then the board's fiduciary duties are owed to the corporation's creditors, not its stockholders.[46] If a financially struggling corporation is in a grey area known as the 'zone of insolvency,' then its directors have a duty to maximise the enterprise value of the corporation for the benefit of all those with an interest in it.[47]

Limited liability companies (LLCs)

Recently, private equity firms have begun to prefer Delaware LLCs over corporations when structuring an investment. Delaware law allows sponsors and their co-investors to craft custom LLC governance provisions, including the total elimination of voting rights and fiduciary duties (other than the contractual duty of good faith and fair dealing),[48] which streamline decision-making and avoid potential personal liability of sponsor board representatives. The added flexibility of an LLC is both a benefit and a burden, as Delaware courts have consistently held that any modification to traditional corporate principles must be clearly and unambiguously stated in the LLC's operating agreement; otherwise, traditional corporate principles will apply (perhaps in unexpected ways).

Using an LLC, which is treated like a partnership for tax purposes, eliminates corporate-level tax and thus can also be more tax-efficient for certain investors. Non-US investors who are not US taxpayers, however, must exercise caution when investing in an LLC, as they may be obligated to pay US income tax on their US effectively connected income and to file a US tax return.

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44 Delaware General Corporation Law Section 145.

45 *In re Trados* (Del Ch 2013).

46 *Geyer v. Ingersoll* (Del Ch 1992).

47 *North American Catholic Educational Programming Foundation, Inc v. Gheewalla* (Del Sup Ct 2007).

48 See Ginsburg, Levin and Rocap (footnote 28), Section 1602.3.

III DEBT FINANCING

The huge US market for acquisition debt financing is highly sophisticated and efficient, with many experienced investors and service providers and multiple options for a private equity sponsor seeking to finance an acquisition. While the market has recovered from its post-financial crisis lows, it remains sensitive – particularly for deals over $100 million – to changes in the broader markets.

No two deals are the same, and the availability of certain types of debt financing depends on market conditions, but US LBO financing structures typically fit into one of the following categories:

a senior and bridge loans, with the bridge loan usually backstopping a high-yield bond offering, typically used in very large deals;

b first-lien and second-lien loans, typically used in upper-middle-market deals, with the availability and pricing of second-lien debt highly dependent on market conditions;

c senior and mezzanine loans, typically used in lower to upper-middle-market deals; and

d senior loan only, typically only used in smaller deals or deals in which the private equity sponsor is using very little leverage.

Except for smaller deals ($100 million or less), most lending facilities are arranged by a financial institution and then syndicated to other lenders,[49] including banks, hedge funds and special purpose entities – known as collateralised loan obligations – created to invest in such loans.

Because UK-style 'certain funds' debt financing is not available in the US, the parties to an LBO – the lenders, the private equity sponsor and even the target – inevitably face market risk between execution of the acquisition agreement and closing. Those parties, particularly the sponsor, must therefore carefully manage that risk in the agreements, especially in the interplay among the debt and equity financing commitment letters and the acquisition agreement.[50]

The non-pricing terms (i.e., excluding items such as fees, interest rates and original issue discounts) of an LBO loan – e.g., affirmative, negative and financial covenants, collateral requirements and defaults – vary considerably from one deal to the next based on the size of the transaction and the perceived creditworthiness of the borrower.[51] In general, however, loans for smaller deals are more similar to one another with respect to affirmative, negative and financial covenant requirements. Non-pricing terms for larger loans occupy a wide spectrum ranging from a full covenant package to 'covenant-lite' loans, where financial maintenance covenants apply only to revolving credit facility draws in excess of a specified amount. In a syndicated loan, key terms, including pricing

49 The 'marketing period' for a syndicated loan, during which the institution arranging the loan assembles the lending syndicate, typical runs for between three and four weeks.

50 See discussion in Section I, *supra*.

51 Many middle market and most – if not all – larger loans are rated by credit rating agencies such as S&P and Moody's.

and debt structure, are typically subject to some limited changes in favour of the lenders – referred to as 'flex' – in the event that the loan cannot be syndicated in the absence of such changes (which may not include, however, additional conditions precedent to funding).

IV OUTLOOK

Positive economic trends, the continued availability of debt financing, an abundance of dry powder and vibrant M&A and IPO markets points to a positive 2015 for US private equity. We expect 2014's primary theme for US private equity investments – the dominance of the middle market and an emphasis on monetising existing investments – to continue into 2015. Concerns remain: deflation risks in Europe and elsewhere, the spectre of sovereign debt default and possible euro exits, and declining oil prices all could lead to economic disruptions and dampen private equity investment activity. On the other hand, US private equity firms have proved their ability to thrive in changing and challenging times, with many posting solid returns in the midst of the Great Recession, others successfully managing the difficult process of leadership change and the industry as a whole adapting to an entirely new regulatory regime.

Appendix 1

ABOUT THE AUTHORS

LISA CAWLEY

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Lisa Cawley heads the financial service regulatory practice in Kirkland's London office. She has extensive experience in both financial regulation and corporate matters, gained over 20 years. Described by *The Legal 500* as having an 'excellent understanding of the UK regulatory regime', she advises on a wide range of regulatory matters.

NORBERT B KNAPKE II

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Norbert Knapke is a corporate partner in Kirkland's Chicago office. His practice focuses on strategic and leveraged acquisitions, recapitalisations and divestitures, senior bank financings, subordinated debt financings, equity financings, executive compensation matters, the acquisition and financing of financial assets, and advising private companies on various corporate matters. Mr Knapke is also Kirkland's partner in charge of firm-wide corporate knowledge management, and responsible for the development and implementation of Kirkland's corporate training programmes, precedent development and overall practice awareness.

Mr Knapke received his BA degree in 1987 from the University of Notre Dame, where he graduated *magna cum laude* and was inducted into the Phi Beta Kappa Society. He received his JD in 1992 from the Duke University School of Law, where he was a member of the *Duke Law Journal* editorial board, graduated *magna cum laude* and was inducted into the Order of the Coif. After law school, Mr Knapke clerked for the Honourable John T Noonan, Jr, a judge on the US Court of Appeals for the Ninth Circuit.

ANDRÉS C MENA

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Andrés Mena is a partner in the New York corporate group of Kirkland & Ellis LLP. He concentrates his practice on debt finance and secured lending, specifically in acquisition and leveraged financings for private equity and corporate clients. He has worked on a broad range of LBO financings, including cross-border, working capital, asset-based, restructurings and debtor-in-possession transactions. He is part of the firm's Latin American practice.

Mr Mena is a graduate of the University of Chicago Law School (LLM, 2000) and the Universidad de Chile in Santiago (JD, 1998). Prior to being admitted to the New York Bar, he practised in Chile as an associate at Morales & Besa in Santiago, focusing on corporate finance matters.

MARK MIFSUD

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Mark Mifsud is a private funds partner in the London office of Kirkland & Ellis International LLP and has been consistently recognised as a leading lawyer in his field. In its 2013 directory, *Chambers UK* again ranked Mr Mifsud as Tier I, and it also ranked the London private funds practice as top-tier in London. It noted that Mr Mifsud is 'a superb lawyer in this field'.

He has extensive experience in advising private fund managers in relation to the structuring and establishment of a wide range of private investment funds, including private equity, real estate, infrastructure and debt funds, and also secondaries, incentive schemes, carried-interest arrangements and co-investment plans, all on an international basis. He also advises private investment managers, significant limited partners and other parties on related matters and general corporate finance.

STEPHEN L RITCHIE

Kirkland & Ellis LLP

Stephen L Ritchie is a partner in the Chicago office of Kirkland & Ellis. His practice is concentrated in the areas of complex business transactions, with a particular focus on structuring, negotiating and managing the legal aspects of mergers, acquisitions, leveraged buyouts, recapitalisations, venture capital and growth equity investments, restructurings and workouts. He has also served as lead counsel in the representation of numerous portfolio companies of private equity funds.

Praised by clients for achieving 'remarkable results on divestitures' and by peers as 'one of those great lawyers who is easy to work with', Mr Ritchie has been recognised by *Chambers USA*, *America's Leading Lawyers for Business* in corporate/M&A/private equity every year from 2006–2014. He was also named *Best Lawyers*' 2013 Chicago Leveraged Buyouts and Private Equity Law 'Lawyer of the Year'. He has also been listed in *The Best Lawyers in America* every year from 2007–2014 and as one of Illinois' Super Lawyers every year from 2005–2014. He has been recognised by *The Legal 500 US* in 2012, 2013 and 2014 for his work in private equity buyouts.

Mr Ritchie has handled many private equity, LBO, venture capital and M&A transactions for GTCR, CHS Capital, Chicago Growth Partners, Evergreen Pacific Partners, William Blair Capital Partners, Wind Point Partners, Technology Crossover Ventures, Solera Holdings, Inc (NYSE: SLH) and others.

He is a lecturer at the University of Chicago Law School, teaching 'Private Equity Transactions: Issues and Documentation' (2011–present), and is a member of the American Bar Association.

JANE SCOBIE

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Jane Scobie is a tax partner in Kirkland's London office. She has a wide range of experience in the corporation tax, VAT and stamp duty aspects of commercial transactions with a private equity bias including investments, private and public company takeovers, and corporate restructurings. Her practice also includes employment taxation and other aspects of share incentive arrangements.

She has extensive experience advising clients on the tax aspects of complex business transactions, including private fund formation and other issues relating to private funds.

FRANK SUN

Kirkland & Ellis

Frank Sun is a corporate partner in the Hong Kong office of Kirkland & Ellis. Qualified in the State of New York, Hong Kong and the PRC, he focuses his practice on private equity investment and mergers and acquisitions, and has extensive experience in representing private equity funds and private and public companies in a variety of public and private M&A transactions. In recent years, he led the execution of a series of complex China-related transactions on behalf of private equity clients such as Carlyle, Citi Securities International and Ontario Teachers Pension Plan Board, and US or Hong Kong-listed companies including Qihoo 360 Technology Co Ltd, Vipshop Holdings Limited and China Traditional Chinese Medicine Co Limited.

CHERYL YUAN

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Cheryl Yuan is a corporate partner in the Shanghai office of Kirkland & Ellis International LLP. She represents private equity funds and private and public companies in complex business transactions, including leveraged buyouts, take-privates, mergers and acquisitions, joint ventures, middle market and growth equity investments, distressed acquisitions and general corporate matters. She has broad experience counselling clients in a variety of industries including health care, media, technology, consumer products, specialty chemicals, manufacturing, aviation and business services. She has handled matters on behalf of several private equity clients, including CDH Investments, Shanghai Pudong Science and Technology Investment Co, Ltd, Bain Capital Asia, Advantage Partners, GTCR, Ontario Teachers Pension Plan Board, L Capital, Sankaty Advisors, Vestar Capital Partners, ABRY Partners, Apax Partners, FTV Capital, Irving Place Capital, Sentinel Capital Partners, ICV Partners and Lincolnshire Management and various public and private companies, including Ganji, Xiu.com, Bristol-Myers

Squibb, Kellogg Company, Tronox Incorporated, Stuart Weitzman, Health Grades, Inc, IMG Worldwide, Inc and The Sun Products Corporation.

FRANCISCO GUZMÁN

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Francisco Guzmán is a senior associate at Carey. He concentrates his practice in M&A, private equity and venture capital transactions.

Mr Guzmán was awarded an LLM from Columbia Law School in 2010 (a James Kent Scholar, the highest honour awarded by the law school) and a JD from the Catholic University of Chile in 2006 (*magna cum laude*). He is admitted to practise law in New York (2010) and Chile (2006). Prior to working at Carey, Mr Guzmán practised at White & Case LLP in New York.

In 2008 he was an adjunct professor of commercial law at the Catholic University of Chile, and is the author of *Información Privilegiada en el Mercado de Valores* ('Inside Information in the Securities Market', LexisNexis, 2007).

Mr Guzmán has been recognised as one of the leading lawyers in Chile in M&A by *Who's Who Legal* and *Latin Lawyer*.

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