

BDC Leverage Caps to Increase, Creating Potential Opportunity for Credit and Private Equity Managers

PENpoint

The recently passed Consolidated Appropriations Act increases BDC leverage limits and includes measures designed to ease certain offering and regulatory burdens applicable to BDCs.

The Consolidated Appropriations Act, 2018, which was signed into law on March 23, 2018 (the “2018 Spending Bill”), included a long sought-after measure to increase business development company (“BDC”) leverage limits. The measure increases the permitted leverage ratio of total debt to equity from one-to-one to two-to-one and streamlines certain regulatory requirements for BDCs. As the BDC market is occupied in large part by private equity managers and, in particular, credit managers seeking assets for credit strategies, this change is a significant development.

BDCs were created by Congress in 1980 to increase retail access to capital markets for small and growing U.S. operating companies. BDCs can be thought of as hybrid investment companies that typically engage in private equity or private credit fund-like investment activities but benefit from the relaxation of certain restrictions otherwise applicable to investment companies registered under the Investment Company Act of 1940 (the “1940 Act”).¹ BDCs frequently are of interest to private equity and private credit fund sponsors, as they combine certain appealing aspects of private funds, such as the ability of the manager to receive performance-based compensation, with certain benefits associated with closed-end, 1940 Act-registered funds, such as the ability to access retail investors, have an “evergreen” pool of capital to manage, and flow-through tax treatment under Subchapter M of the Internal Revenue Code (which can be more favorable for certain types of investors or strategies).

While industry groups have long lobbied for increased leverage limits for BDCs, historically there has been some opposition to such measures from both Congress

and the SEC² as a result of concerns that increased leverage could lead to increased risk for retail investors. Industry advocates have countered that the one-to-one leverage limit has forced BDCs to move down the capital structure in portfolio company investments to create competitive yield, which itself increases risk, and that permitting greater leverage would enable more investment in small and mid-size businesses, creating jobs and improving the economy.

In addition to increasing leverage limits, the 2018 Spending Bill included measures designed to ease certain offering and regulatory burdens applicable to BDCs by, among other things, directing the SEC to:

- allow certain established BDCs to file automatically effective shelf registration statements;
- permit BDCs to take advantage of certain communication rules under the Securities Act of 1933, which would relax certain restrictions in the securities offering process; and
- let some BDCs incorporate by reference certain of their periodic reports to the SEC, allowing for the automatic updating of certain registration statements.

Together these changes are expected to increase the ease of and market interest in BDC securities offerings.

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¹ Like other registered investment companies, BDCs are subject to regulation under the 1940 Act, including restrictions on governance, investment activities and affiliated transactions and periodic public reporting and other requirements. While BDCs have the advantage of certain reduced burdens relative to other types of investment companies, there remain complex regulatory and other issues not applicable to private funds that should be considered during formation and throughout management of a BDC.

² See e.g., Letter from SEC Chair Mary Jo White to House Financial Services Committee, Nov. 2, 2015.

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PENbriefs

Trump Administration Imposes Steel and Aluminum Tariffs, Linking International Trade and National Security

On March 23, 2018, tariffs of 25 percent on imported steel and 10 percent on imported aluminum went into effect for all countries not issued an exemption. The tariffs represent one of the administration's most assertive trade actions to date and are another front in a broader effort to more closely link certain international trade issues with broader U.S. national security concerns. Although the tariffs remain subject to change, companies would be well-advised to conduct a thorough value-chain vulnerability analysis of tariff risks. To learn more, see our recent [Alert](#).

Trump Administration Bans Dealings in Venezuelan Cryptocurrency in a First Step Toward Extending Sanctions to Digital Currency Transactions

On March 19, 2018, President Trump issued an Executive Order that prohibits U.S. persons from engaging in dealings in any digital currency, coin or token issued by, for or on behalf of the Venezuelan government. The U.S. Department of Treasury Office of Foreign Assets Control (OFAC) issued corresponding guidance that lays the groundwork for potential sanctions related to digital currency transactions more generally. Taken together, these actions may foreshadow OFAC asserting jurisdiction over cryptocurrency in other sanctions programs. To learn more, see our recent [Alert](#).

Treasury Department Sanctions Russian Entities and Individuals for Cyberattacks and Election Interference

The U.S. Department of Treasury Office of Foreign Assets Control recently designated five entities and 19 individuals in response to Russian cyberattacks and Russia's apparent interference in the 2016 U.S. presidential election. The announcement consisted of related cyber sanctions on two types of parties: malicious cyber actors and cyber actors operating on behalf of the Russian government. To learn more, see our recent [Alert](#).

SEC, DOJ Levy Insider Trading Charges in Connection with Data Breach

On March 14, 2018, the U.S. Securities and Exchange Commission and U.S. Department of Justice civilly and criminally charged a former Equifax executive for allegedly selling Equifax stock after learning about the company's 2017 data breach. This represents the first time that the SEC or DOJ has charged a corporate executive, whether civilly or criminally, in connection with a data breach. To learn more, see our recent [Alert](#).

PENbriefs

Proposed Export Control Legislation Would Place New Restrictions on Technology Transfer

On February 15, 2018, U.S. House of Representatives Foreign Affairs Committee Chairman Ed Royce introduced the Export Control Reform Act of 2018, which could have a significant impact on restricting access to U.S. technology, even within the U.S. The Act, which responds to bipartisan concerns regarding the transfer and use of domestic technology, could increase compliance complexity and heighten enforcement risk. To learn more, see our recent [Alert](#).

Recent Developments in the Regulation of Methane Venting and Flaring from Natural Gas Wells on Public and Tribal Lands and Potential Next Steps

A California federal court recently ordered the U.S. Bureau of Land Management (BLM) to enforce the Obama-era Waste Prevention Rule, which limits methane venting and flaring from natural gas wells and on public and tribal lands. Investors and operators in the oil and gas markets should actively monitor related regulatory and legal activity, and engage in BLM's Rescission Rule rulemaking process, to determine potential regulatory impacts on their businesses. To learn more, see our recent [Alert](#).

PENnotes

2018 Kellogg Private Equity and Venture Capital Conference Chicago, IL, April 25, 2018

Kirkland is a sponsor of this annual student-led conference, which brings industry professionals, alumni, students and Kellogg faculty together for a day of discussion on the current state of the industry and its most pressing issues. Kirkland partner Richard Campbell will moderate a panel on "Add-On Acquisitions as a Source of Value." Click [here](#) for more information.

PEI Private Fund Compliance Forum 2018 New York, NY, May 8-9, 2018

This event will examine critical changes in the regulations governing private equity and the impact on compliance processes, and provide the latest approaches for managing firms' compliance programs. Kirkland is a sponsor of the event, and partner Alpa Patel will be a panelist on "Identifying conflicts at your firm." Click [here](#) for more information.

2018 SuperReturn Energy Boston, MA, June 18-19, 2018

Kirkland is a sponsor of this specialized energy private equity event. Bringing LPs and GPs together, SuperReturn Energy provides a platform for energy investors to come together to share expertise, build

partnerships and do deals. Kirkland partner John Pitts will participate on the "Private Equity Oil & Gas Deal Sourcing." panel Click [here](#) for more information.

Private Debt Investor CFOs & COOs Forum 2018 New York, NY, June 20-21, 2018

Kirkland is a sponsor of this event, which will delve into the complexities of managing the finance and operations of firms that invest across the capital structure, including senior secured loans, subordinated debt, hybrid financing and more. Kirkland partner Stephanie Berdik will address how LPs evaluate private debt and credit funds, and partner Norm Champ will discuss the before and after of an SEC exam. Click [here](#) for more information.

PLI Annual Private Equity Forum New York, NY, July 16-17, 2018

This annual event is designed to provide an overview of the legal issues that need to be considered in marketing a private equity fund, current regulatory and compliance hot buttons, issues in negotiating the terms of private equity funds, GP-led fund restructurings, sponsor stake sales, and other developments. Kirkland partner Andrew Wright will speak on "General Partner Arrangements: Structure and Terms." Click [here](#) for more information.

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Kirkland & Ellis' nearly 500 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and fund formations on behalf of more than 400 private equity firms and hedge funds around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in each of the last seven years by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. U.S. News Media Group and Best Lawyers have ranked Kirkland as a Tier 1 law firm for Leveraged Buyouts and Private Equity Law for seven consecutive years and as a top-tier firm for Private Funds/Hedge Funds Law since 2012. The Firm was recognized as the #1 law firm for private equity in the 2018 Vault 100 rankings, and, in 2016, Private Equity International named the Firm "Law Firm of the Year in North America: Fund Formation" for the third year in a row.

In 2012-2017, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011-2016*, and has consistently received top rankings among law firms in Private Equity by The Legal 500, the Practical Law Company and IFLR, among others.

The Lawyer magazine has recognized Kirkland as one of its "Transatlantic Elite," having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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