GETTING THE DEAL THROUGH

Private Equity

Fund formation and transactions in 42 jurisdictions worldwide

2009

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Formation and terms operation

1 Forms of vehicle

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

In the United States, LBO funds are typically formed as limited partnerships in the state of Delaware, pursuant to the Delaware Revised Uniform Limited Partnership Act (DRULPA). A limited partnership formed under the DRULPA will have a separate legal personality, the existence of which will continue until cancellation of the limited partnership's certificate of limited partnership. A Delaware limited partnership offers investors the benefits of limited liability as well as flow-through tax treatment in the US. The liability of a limited partner is generally limited to the amount of the capital contributed or that has been agreed to be contributed (or returned) by such investor. The 'manager' is the general partner of the fund with control over and unlimited liability for the obligations of the partnership.

2 Forming an LBO fund vehicle

What is the process for forming an LBO fund vehicle in your jurisdiction?

A limited partnership requires at least one general partner and one limited partner, neither of which needs to be a Delaware entity. To form a limited partnership, the general partner must execute and file a brief certificate of limited partnership setting forth certain basic information about the partnership. In Delaware, this filing is made with the secretary of state's office. Each Delaware limited partnership must have and maintain (and identify in its certificate of limited partnership) a registered office and a registered agent for service of process on the limited partnership in Delaware. The certificate of limited partnership must also identify the name of the partnership and the name and address of the general partners, although the names of the limited partners need not be disclosed. In addition, depending on the US jurisdictions in which the LBO fund conducts its business, it may be required to obtain qualifications or authorisations (as well as comply with certain publication requirements) to do business in such jurisdictions. There is generally no time delay associated with filing the certificate of limited partnership; it can normally be prepared and filed on a same-day basis. The initial written limited partnership agreement to be entered into in connection with the formation of a limited partnership can be a simple form agreement, which can be amended and restated with more detailed terms at a later date. For a limited partnership formed in Delaware, the partnership agreement need not be publicly filed. The fee for filing a certificate of limited partnership in Delaware is US$200. There is an annual franchise tax of US$250. The fees for obtaining authorisation to do business in a particular jurisdiction are usually nominal but may be more costly in certain states. There are no minimum capital requirements for a Delaware limited partnership.

An LBO fund will typically engage counsel to draft the certificate of limited partnership and the related partnership agreement. Filings in Delaware, as well as in other jurisdictions where an authorisation to do business is required, are typically handled by a professional service provider for a nominal fee (which also provides the registered agent and registered office services referred to above).

3 Requirements

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

A Delaware limited partnership must have and maintain a registered office and a registered agent for service of process in the state of Delaware. This requirement is typically satisfied by the partnership engaging for a nominal fee a professional service provider to act in these capacities (see question 2). Although under the DRULPA a limited partnership must maintain certain basic information and records concerning its business and its partners (and in certain circumstances provide access thereto to its partners), there is no requirement that such documents be kept within the state of Delaware. There is no requirement under Delaware law to maintain a custodian or administrator, although registered investment advisers under the Investment Advisers Act of 1940, as amended (the Advisers Act) must maintain an independent custodian of client assets.

4 Access to information

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

Although the DRULPA provides that limited partners are entitled (if they have a proper purpose) to receive a list of the names, addresses and capital commitments of the other partners, a copy of the partnership agreement and any amendments thereto and certain other information, the limited partnership's partnership agreement may limit or expand this. Further, the partnership agreement may, and typically does, provide that any such information provided to limited partners is confidential and is not to be disclosed by a limited partner to third parties. Therefore, the public is not generally entitled to information (other than the identity of the general partner, which is set forth in the certificate of limited partnership) about Delaware limited partnerships. Nevertheless, as a result of the US Freedom of Information Act (FOIA), certain similar state public records access

laws and other similar laws, certain limited partners who are subject to such laws may be required to disclose certain information in their possession relating to the partnership. Generally, the information that has been released to date pursuant to the FOIA and similar laws has typically been 'fund level' information (eg, overall internal rates of return, other aggregate performance information, amounts of contributions and distributions, etc) but not 'portfolio company level' information (eg, information relating to individual investments by the fund). Also, limited partnership agreements and the list of limited partners have generally been protected from disclosure. A general partner's failure to comply with the reporting requirements of applicable law or the partnership agreement could result in a limited partner seeking injunctive or other equitable relief or monetary damages (or both).

5 Limited liability for third-party investors

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

Under Delaware partnership law, a limited partner is not liable for the obligations of a limited partnership unless such limited partner is also a general partner or, in addition to the exercise of rights and powers of a limited partner, such limited partner participates in the 'control of the business' of the partnership within the meaning of the DRULPA. It is generally possible to permit limited partners to participate in all aspects of the internal governance and decision-making of the partnership without jeopardising the limited liability status of a limited partner. Even if the limited partner does participate in the control of the business within the meaning of the DRULPA, such limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

In addition, under the DRULPA a limited partner who receives a distribution made by a partnership and who knew at the time of such distribution that the liabilities of the partnership exceeded the fair value of the partnership's assets is liable to the partnership for the amount of such distribution for a period of three years from the date of such distribution, and partnership agreements of LBO funds commonly impose additional obligations to return distributions. There may be additional potential liabilities pursuant to applicable fraudulent conveyance laws. In any case, limited partners are liable for capital contributions and any other payment obligations set forth in the limited partnership agreement to which they are a party.

6 Fund manager's fiduciary duties

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

A general partner of a limited partnership will generally owe fiduciary duties to the partnership and its partners, which include the duties of candour, care and loyalty. However, to the extent that, at law or equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by the provisions in the partnership agreement, provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing. A partnership agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a partner or other person to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, provided that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

7 Gross negligence

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

Delaware does recognise a gross negligence standard of liability. The exculpation and indemnification provisions in an LBO fund's limited partnership agreement typically carve out acts or omissions that constitute 'gross negligence'.

8 Other special issues or requirements

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

Restrictions on transfers and withdrawals, restrictions on operations generally, provisions regarding fiscal transparency, special investor governance rights on matters such as removal of the manager or early dissolution of the LBO fund are all matters typically addressed in the provisions of the partnership agreement and will vary from fund-to-fund. Typically, the partnership agreement will require the consent of the general partner to effect a transfer of a limited partnership interest. This requirement enables the general partner to maintain the fund's compliance with applicable legal, tax and regulatory requirements and exemptions, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. Although there is generally no right to withdraw from a Delaware limited partnership under the DRULPA, the limited partnership agreement for an LBO fund may provide for certain withdrawal rights for limited partners, typically only in limited circumstances for legal and regulatory reasons. Limited partners have the right to petition the Delaware Court of Chancery for withdrawal or similar equitable relief in egregious circumstances (eg, fraud); however, obtaining such relief can be difficult.

In converting or redomiciling a limited partnership formed in a non-US jurisdiction into a limited partnership in a US jurisdiction (eg, Delaware), particular attention should be given to requirements of the certificate of limited partnership domestication that may be required to be filed, as well as any other requirements of the applicable state's laws relating to maintaining a limited partnership in such jurisdiction. (See, eg, question 2.) In addition, depending on where the redomiciled fund conducts its business, it may be required to obtain qualifications or authorisations to do business in certain jurisdictions. Any provisions of the partnership law of the state into which such domestication is effected that are otherwise inconsistent with the pre-existing governing agreement of such partnership should be reviewed and modified as necessary to ensure conformity with the applicable law. Consideration should also be given to the tax consequences of converting or redomiciling a limited partnership.

Certain aspects of US securities laws apply differently with respect to US and non-US LBO funds. For example, in determining whether an LBO fund formed in the US will qualify for exemption from registration under the Investment Company Act 1940, as amended (the Investment Company Act), all investors, both US and non-US, are analysed for determining the fund's compliance with

the criteria for exemption. By contrast, in the case of an LBO fund formed in a jurisdiction outside the US, only US investors are analysed for the purposes of making that same determination (assuming certain other requirements are met).

The Securities and Exchange Act 1934, as amended (the Exchange Act) and the regulations promulgated thereunder generally require that any issuer having 500 holders of a class of equity security and assets in excess of US$10 million register the security under the Exchange Act and comply with periodic reporting and other requirements of the Exchange Act. These rules have the practical effect of imposing a limit of 499 investors in any single US-domiciled LBO fund. However, the Exchange Act and the regulations promulgated thereunder provide an exemption from the 500 holder rule described above for a non-US domiciled LBO fund that qualifies as a 'foreign private issuer' and has fewer than 300 holders of equity securities resident in the US. An LBO fund that is organised outside of the US generally qualifies as a 'foreign private issuer' unless more than 50 per cent of its outstanding voting securities is held by US residents or any of the following is true: a majority of its officers and directors are US citizens or residents, more than 50 per cent of its assets are located in the US or its business is principally administered in the US.

9 Fund Sponsor bankruptcy or change of control

With respect to institutional sponsors of LBO funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the LBO fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the LBO fund's sponsor (eg, automatic trigger of dissolution or removal rights at fund level)?

Depending on the structure of the LBO fund and its general partner and the specific provisions of their operating agreements, the bankruptcy or insolvency of the ultimate sponsor of an LBO fund could result in the bankruptcy or dissolution of the LBO fund's general partner or adviser or of the fund itself. Moreover, such a bankruptcy or insolvency event could result in the inability of the sponsor to meet its funding obligations with respect to its capital commitment to the LBO fund. Depending on the terms of the LBO fund's partnership agreement, such a default could constitute a 'cause' event and thereby trigger rights of the limited partners to remove the LBO fund's general partner, dissolve the LBO fund itself or cause the forfeiture of all or a portion of the general partner's unrealised carried interest. In addition to such for 'cause' protections, a sponsor bankruptcy may result in a LBO fund's limited partners seeking to exercise the 'no-fault' remedies included in many partnership agreements, which often permit termination of the investment period, removal of the LBO fund's general partner or dissolution of the LBO fund. With respect to US bankruptcy law, a sponsor that has filed for reorganisation under Chapter 11 of the bankruptcy code should still be permitted to operate non-bankrupt subsidiaries (including, for example, related LBO funds and their general partners) as ongoing businesses, although this raises a variety of operational issues, including, for example, whether ordinary course investment and LBO fund management decisions must be approved by the bankruptcy court. A change of control or similar transaction with respect to an institutional sponsor may also give rise to statutory and contractual rights and obligations, including a requirement under the Advisers Act for registered advisers that effective 'client' consent (ie, the LBO fund's limited partners or a committee thereof) be obtained for the transaction or rights of the limited partners under the LBO fund's partnership agreement to cancel the commitment period, dissolve the fund or remove the general partner.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over an LBO fund and its manager in your jurisdiction, and what are the audit and inspection rights available to those regulators?

The US Securities and Exchange Commission (SEC) has the authority to regulate investment advisers pursuant to the Advisers Act. Investment advisers may also be subject to regulatory requirements at state level. Although almost all LBO fund managers fall within the definition of 'investment adviser' under the Advisers Act, most LBO fund advisers are able to avoid the requirements of the Advisers Act in reliance on the 'private adviser' exemption from registration for investment advisers with 14 or fewer clients (for this purpose, each LBO fund is generally a 'client' rather than each investor therein) and who meet certain other requirements. Similar exemptions from state-level regulation are available in many states. Nevertheless, even unregistered advisers are subject to the general anti-fraud provisions of the Exchange Act, the Advisers Act, state laws, and, if required to register as a broker-dealer with the Financial Industry Regulatory Authority (FINRA) (see question 11), similar rules promulgated by FINRA, and the SEC and many of the analogous state regulatory agencies retain statutory power to bring actions against an LBO fund sponsor under these provisions. Those advisers who do register under the Advisers Act (either voluntarily or because there is no applicable exemption) are subject to periodic compliance inspections conducted by the SEC and perhaps certain state regulators. Legislation has recently been introduced in the US Congress that, if adopted as presently drafted, would eliminate the 'private adviser' exemption from the Advisers Act. As of the date of publication, this bill has not been enacted.

11 Governmental requirements

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

The offering and sale of interests in an LBO fund are typically conducted as 'private placements' exempt from the securities registration requirements imposed by the Securities Act of 1933, as amended (the Securities Act), the regulations thereunder and applicable state law. In addition, most LBO funds require their investors to meet certain eligibility requirements so as to enable the funds to qualify for exemption from regulation as investment companies under the Investment Company Act. Accordingly, there are no approval, licensing or registration requirements applicable to an LBO fund that offers its interests in a valid private placement and qualifies for an exemption from registration under the Investment Company Act. Legislation has recently been introduced in the US Senate that, if adopted as presently drafted, would technically eliminate the two exemptions under the Investment Company Act commonly utilised by LBO funds. Such legislation generally would then require LBO funds that have US$50 million or more in assets and that previously relied on these two exemptions to register on a limited basis with the SEC, including the filing of information for public disclosure such as the identity of investors and the value of fund assets. As of the date of publication, this bill has not been enacted.

As a general matter, LBO funds with 'significant' participation by US corporate pension plans (ie, over 25 per cent of investors' capital

commitments are from investors using assets of US corporate pension plans) must be operated to qualify as a venture capital operating company (VCOC), which generally entails having on its initial investment date and annually thereafter at least 50 per cent of the LBO fund's assets, valued at cost, invested in 'operating companies' as to which the LBO fund obtains by contract management rights and exercising such management rights with respect to one or more of such investments during the course of each year in the ordinary course of business. (See question 10.)

The sponsor of an LBO fund engaging in certain types of corporate finance or financial advisory services may be required to register as a broker-dealer with FINRA and be subject to similar audit and regulation.

12 Registration of investment adviser

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

Absent an applicable exemption, an LBO fund's manager will be subject to registration as an investment adviser under the Advisers Act. Many managers of LBO funds satisfy the 'private adviser' exemption from registration for investment advisers with 14 or fewer clients (which typically counts an LBO fund as a single client under current law and regulations) and who meet certain other requirements. Analogous exemptions from registration with state securities regulators are available under many states' laws as well. (See question 10, including with respect to recent legislative developments surrounding the 'private adviser' exemption.)

13 LBO fund manager – requirements

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

There are no such requirements imposed by law on investment advisers. As a matter of market practice, an LBO fund's sponsor is typically expected to make a capital investment either directly in or on a side-by-side basis with the LBO fund. Investors will expect that a significant portion of this investment be funded in cash, as opposed to deferred-fee or other arrangements. Similarly, the required experience level of an LBO fund's management will be dictated by the demands of investors. If required to register as a broker-dealer with FINRA, an LBO fund sponsor would need to satisfy certain standards in connection with obtaining a registration (eg, no prior criminal acts, minimum capital, testing, etc).

Taxation

14 Tax obligations

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

Generally, an LBO fund vehicle, such as a limited partnership or limited liability company, that is treated as a partnership for US federal income tax purposes, would not itself be subject to taxation with respect to its income or gains. Instead, each partner would take into account its distributive share of the partnership's income, gain, loss and deduction.

If the fund generates income that is effectively connected with the conduct of a US trade or business (ECI), the fund will be required to withhold US federal income tax with respect to such income that is attributable to the fund's non-US investors, regardless of whether it is distributed. In general, subject to an exception for investments in certain real estate companies, trading in stock or securities (the principal activity of most LBO funds) is not treated as generating ECI.

The fund will also be required to withhold with respect to its non-US investors' distributive share of certain US source income of the fund that is not ECI (eg, US source dividends and interest) unless, in the case of interest, such interest qualifies as portfolio interest. Portfolio interest generally includes (with certain exceptions) interest paid on registered obligations with respect to which the beneficial owner provides a statement that it is not a US person. A non-US investor who is a resident for tax purposes in a country with respect to which the US has an income tax treaty may be eligible for a reduction or refund of withholding tax imposed on such investor's distributive share of interest and dividends and certain foreign government investors may also be eligible for an exemption from withholding tax on income of the fund that is not from the conduct of commercial activities.

The taxation of an LBO fund vehicle as a partnership for US federal income tax purposes is subject to certain rules regarding 'publicly traded partnerships' which could result in the partnership being classified as an association taxable as a corporation. To avoid these rules, funds commonly are not traded on a securities exchange or other established over-the-counter market and impose limitations on the transferability of interests in the LBO fund vehicle.

15 Local taxation of non-resident investors

Would non-resident investors in an LBO fund be subject to taxation or return-filing requirements in your jurisdiction?

Non-resident investors that invest directly in an LBO fund organised as a flow-through vehicle in the United States would be subject to US federal income taxation and return filing obligations if the LBO fund generates ECI (including gain from the sale of real property or stock in certain 'US real estate property holding corporations') (see question 14). In addition, all or a portion of the gain on the disposition (including by redemption) by a non-US investor of its interest in the fund may be taxed as ECI to the extent such gain is attributable to assets of the fund that generate ECI.

16 Local tax authority ruling

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

Generally, no tax ruling would be obtained with respect to the tax treatment of an LBO fund vehicle formed in the US. While there are many special taxation rules applicable to US investors, of particular relevance are those rules that apply to US tax-exempt investors in respect of unrelated business taxable income (UBTI).

17 Organisational taxes

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

There are no significant taxes associated with the organisation of an LBO fund in the US.

18 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to an LBO fund's sponsor.

Special consideration is given to structure the carried interest such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (ie, the recipient of the carried interest) and the investment manager (ie, the recipient of the management fee) into separate entities (see question 29).

Recently, legislation has been introduced in Congress that, if enacted in its current form, would result in carried interest distributions that are currently subject to favourable capital gains tax treatment to be treated as ordinary income that is generally taxed at a higher rate. Whether such legislation will be enacted (or in what ultimate form) is uncertain. In addition, legislation has recently been introduced in the New York State legislature that, if adopted as presently drafted, would amend the New York tax law to require carried interest distributions received by non-New York State residents performing 'investment management services' for entities doing business in New York as New York-source income. Such legislation generally would result in such non-New York State residents being taxed at the applicable New York State personal income tax rate on such carried interest proceeds. Note that New York State residents are currently taxed on such income. Moreover, it has also been proposed to subject carried interest to the New York City unincorporated business tax. It is unclear whether or to what extent any such legislation will become law.

19 Tax treaties

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

The US has an extensive network of income tax treaties. How a treaty would apply to the fund vehicle depends on the terms of the specific treaty and the relevant facts of the structure.

20 Other significant tax issues

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

US tax rules are very complex and tax matters play an extremely important role in both fund formation and the structure of underlying fund investments. Consultation with tax advisers with respect to the specific transactions or issues is highly recommended.

Selling restrictions and investors generally

21 Legal and regulatory restrictions

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

To ensure that an LBO fund formed in the US will satisfy the requirements necessary to avoid registration with the SEC, an LBO fund sponsor will customarily conduct the offering and sale of interests in the LBO fund to meet a private placement exemption under the Securities Act. The most reliable way to do this is to comply with the 'safe harbour' criteria established by Regulation D under the Securities Act. Compliance with these criteria effectively necessitate, among other requirements, that each investor in the LBO fund be an accredited investor (which generally includes a natural person with a net worth of more than US$1 million or income above US$200,000 in the last two years and a reasonable expectation of reaching the same income level in the current year, and entities with more than US$5 million in assets) and that the sponsor not make any offers or sales by means of general solicitation or general advertising. In 2007, the SEC proposed a new rule under the Securities Act that would require natural persons investing in an LBO fund relying on the 3c1 exemption (defined in the next paragraph) to satisfy the income test set forth in the preceding sentence and to own US$2.5 million in 'investments' as defined in the new rule. As of the date of publication, the proposed rule has not yet been implemented by the SEC. Subsequent to the end of the public comment period for such proposed rule, the SEC issued additional proposed rules that would modify the definition of an 'accredited investor' so that individual investors that own investments of US$750,000 and institutional investors that own investments of US$5 million would also qualify as accredited investors, as would an expanded list of entities, and that beginning in 2012 the monetary thresholds for qualifying as an accredited investor would be periodically adjusted to reflect inflation. As of the date of this publication, both proposed rules have not been finalised or implemented.

To ensure that an LBO fund will satisfy the requirements necessary to avoid regulation as an 'investment company' under the Investment Company Act, each investor in the fund will typically be required to represent that it is a 'qualified purchaser' as defined in section 2(a)(51) of the Investment Company Act. In the event that all of an LBO fund's investors are not qualified purchasers, then the fund may still qualify for an exemption (the 3c1 exemption) by limiting the number of investors to not more than 100 (all of which must still be accredited investors and with respect to which certain 'look through' attribution rules apply). (A 'qualified purchaser' generally includes a natural person who owns not less than US$5 million in investments, a company acting for its own account or the accounts of other qualified purchasers which owns and invests on a discretionary basis not less than US$25 million in investments and certain trusts.) 'Knowledgeable employees' (ie, executive officers and directors of the sponsor and most investment professionals involved with the LBO fund) are ignored for the purposes of the foregoing requirements. If the sponsor of an LBO fund is a registered investment adviser under the Advisers Act, then in certain circumstances each investor may need to represent that it is a 'qualified client' as defined under the Advisers Act. (A 'qualified client' generally includes a natural person or company with a net worth exceeding US$1.5 million or that has US$750,000 under management with the adviser.) (See question 11 with respect to recent legislative developments concerning exemptions available to LBO funds under the Investment Company Act.)

An LBO fund relying on the private placement safe harbour contained in regulation D under the Securities Act should file with the SEC a notice on Form D within 15 days after the first sale of securities. Form D sets forth certain basic information about the offering, including the amount of securities offered and sold as well as the states in which purchases were solicited, and requires disclosure of each investor holding 10 per cent or more of the voting securities of any such LBO fund. Certain states also have similar notice-filing requirements. Beginning 16 March 2009, every Form D filed with the SEC must be filed electronically on new Form D. With respect to the filing deadline for the new Form D, the SEC is interpreting 'sale' as the date on which the first investor is irrevocably contractually committed to invest, which, depending on the terms and conditions of the contract, could be the date on which the LBO fund receives the investor's subscription agreement and not necessarily as late as the closing date. Because practitioners have generally treated the closing date as the trigger date, certain committees of the American Bar Association have asked the SEC to reconsider and instead make the trigger the closing date. As of the date of publication, the SEC has not provided further guidance on this issue.

22 Types of investor

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

Other than compliance with certain aspects of the anti-money laundering provisions of the USA PATRIOT Act (the Patriot Act) discussed in question 25, as a general matter there are no such restrictions other than those imposed by applicable securities laws described above or which may arise under the laws of other jurisdictions. Sponsors of LBO funds may choose to limit participation by certain types of investors in the light of applicable legal, tax and regulatory considerations and the investment strategy of the fund. Restrictions may be imposed on the participation of non-US investors in an LBO fund in investments by the LBO fund in certain regulated industries (eg, airlines, shipping, telecommunications and defence).

23 Identity of investors

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

There is generally no requirement to notify the state of Delaware or the SEC as a result of a change in the identity of investors in an LBO fund formed in Delaware (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager, except that in the case of a manager or investment adviser registered under the Advisers Act, changes in identity of certain individuals employed by or associated with the investment adviser must be reflected in an amendment to part I of the adviser's Form ADV promptly filed with the SEC and in certain circumstances a change of control of the manager or investment adviser may require the consent of the investors in the LBO fund. (See question 21 regarding disclosure of the identity of holders of 10 per cent or more of the voting securities of an LBO fund filing a Form D.) In the event of a change of the general partner of a Delaware limited partnership, an amendment to the fund's certificate of limited partnership would be required to be filed in Delaware. Additionally, an LBO fund that makes an investment in a regulated industry, such as banking, insurance, airlines, telecommunications, shipping, defence, energy and gaming, may be required to disclose the identity and ownership percentage of fund investors to the applicable regulatory authorities in connection with an investment in any such company.

24 Licences and registrations

Does your jurisdiction require that the person offering interests in an LBO fund have any licences or registrations?

Generally, the sponsor of an LBO fund in the US would not be required to register as a broker or dealer under the Exchange Act as they are not normally considered to be 'engaged in the business' of brokering or dealing in securities. The rules promulgated under the Exchange Act provide a safe harbour from requiring employees and issuers to register as a broker or dealer subject to certain conditions including such employees not being compensated by payment of commissions or other remunerations based either directly or indirectly on the offering of securities. If compensation is directly or indirectly paid to employees of the sponsor in connection with the offering of securities, the sponsor may be required to register as a broker-dealer (see questions 10 and 11). If an LBO fund retains a third party to market its securities, that third party would generally be required to be registered as a broker-dealer.

25 Money laundering

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

Although LBO funds generally are not currently subject to the anti-money laundering regulations of the Patriot Act, the Treasury Department has issued in the past proposed rules that would require advisers of hedge funds and, possibly, LBO funds to adopt anti-money laundering procedures in accordance with the Patriot Act. Although these proposed rules have recently been withdrawn and are not currently effective, as a best practice, many LBO funds have already put into place anti-money laundering programmes that meet the requirements set forth in the Patriot Act's regulations. These requirements include:

- developing internal policies, procedures and controls;
- designating an anti-money laundering compliance officer;
- implementing an employee training programme; and
- having an independent audit function to test the programme.

Currently, there are no regulations in effect that would require the disclosure of the identities of (or other related information about) the investors in an LBO fund or the individual members of the sponsor. However, a bill has recently been introduced in the US Senate that, if adopted as presently drafted, would require LBO funds to publicly disclose the names and addresses of their investors and adopt certain anti-money laundering programmes that could include elements of the Treasury Department's proposed rules, as well as other requirements to be determined by the department in consultation with the SEC and Commodity Futures Trading Commission. (See question 10.) As of the date of publication, the proposed Senate bill has not been enacted. If an investment adviser to an LBO fund is registered under the Advisers Act, the adviser must disclose on Form ADV the educational, business and disciplinary background of certain individuals employed by or associated with the investment adviser. Part I of the adviser's Form ADV is available on the SEC's website. Similar disclosure may be required for advisers that are or have affiliates that are broker-dealers registered with FINRA.

Exchange listing

26 Listing

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

Because of certain adverse tax consequences arising from status as a 'publicly traded partnership' and the difficulty that such a listing would impose on being able to establish an exemption from registration under the Investment Company Act, LBO funds do not typically list on a securities exchange in the US. (See question 14.) The applicable listing requirements would be established by the relevant securities exchange.

27 Restriction on transfers of interests

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

As discussed above, LBO funds do not typically list on any US exchange. However, if listed, the ability of such a fund to restrict transfers of its interest would be dictated by the listing requirements of the relevant securities exchange as well as the other governing agreements of such fund.

Participation in LBO transactions

28 Legal and regulatory restrictions

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

The primary restrictions concerning the types of investments that an LBO fund may make are typically contained in the LBO fund's limited partnership agreement. These restrictions often include limits on the amount of capital that may be deployed in any one investment, a restriction on participation in 'hostile' transactions, certain geographic diversification limits, a restriction on investments that generate certain types of tax consequences for investors (eg, UBTI for US tax-exempt investors or ECI for non-US investors), a restriction on certain types of investments (eg, venture capital investments, direct investments in real estate or oil and gas assets) and so on. Individual investors in an LBO fund may also have the right (either pursuant to the partnership agreement or a side letter relating thereto) to be excused from having their capital invested in certain types of investments (eg, tobacco, military industry, etc).

There may also be limits on and filing requirements associated with certain types of portfolio investments made by an LBO fund. For example, investments in certain media companies may implicate the ownership limits and reporting obligations established by the US Federal Communications Commission (FCC). Other similarly regulated industries include shipping, defence, banking and insurance. Regulatory considerations applicable to M&A transactions generally (eg, antitrust, tender-offer rules, etc) also apply equally to LBO transactions completed by funds. Consideration should also be given to the potential applicability of the Sarbanes-Oxley Act and applicable US state laws relating to fraudulent conveyance issues, as discussed in more detail in the US transactions chapter.

In addition, depending on the composition of an LBO fund's investors, the LBO fund may, to avoid being subject to onerous fiduciary requirements under the Employee Retirement Income Security Act 1974, as amended (ERISA), need to structure its investments in a manner so as to ensure that the LBO fund will qualify as a VCOC, which generally entails having at least 50 per cent of the LBO fund's assets, valued at cost, invested in 'operating companies' as to which the LBO fund obtains by contract management rights and exercising such management rights with respect to one or more of such investments during the course of each year in the ordinary course of business.

Update and trends

- Recently introduced legislation described above would subject LBO funds and their advisers to much greater registration and regulatory requirements.
- Recently introduced legislation described above would tax carried interest from LBO funds as ordinary income.
- The current crisis in global financial markets and the global economy has placed significant constraints on new commitments by all categories of investors to LBO funds and resulted in much higher levels of defaults by investors in existing LBO funds.

29 Compensation and profit-sharing

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

Depending on the state in which an LBO fund is formed and operates, there may be tax advantages to forming separate entities to receive the carried interest and management fee (and other fee) payments in respect of the fund and other unique structuring requirements. For example, funds whose manager has a place of business in New York City typically use this bifurcated structure. Additionally, as noted in question 18, legislation has recently been introduced in Congress that, if enacted in its current form, would result in typical carried interest distributions to be taxed at a higher rate. Moreover, recently enacted legislation limits a sponsor's ability to use fee deferral arrangements to defer payment of tax on compensation and similar profits allocations

The sponsor's ability to take transaction fees is likely to be the subject of negotiation with investors in the fund, who may seek to have a portion of such fees accrue for their account as opposed to that of the sponsor through an offset of such fees against the management fee otherwise to be borne by such investors.

In certain circumstances, depending on the structure of an LBO fund, the manner in which a sponsor may charge a carried interest or management fee can be affected by the requirements of ERISA or the Advisers Act.

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