



Private Equity

in 32 jurisdictions worldwide

Contributing editor: Casey Cogut

2012



Published by
Getting The Deal Through
in association with:

- Advokatfirmaet Steenstrup Stordrange DA
- Advokatfirman Delphi Appleby
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Private Equity 2012
Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 7908 1188
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ISSN 1746-5524

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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United States

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Formation and terms operation

1 Forms of vehicle

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

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

2 Forming a private equity fund vehicle

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

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

There is an annual franchise tax of US\$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.

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

3 Requirements

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

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

4 Access to information

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

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

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

5 Limited liability for third-party investors

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

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

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

6 Fund manager’s fiduciary duties

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

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

of a partner or other person to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, provided that a partnership agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

7 Gross negligence

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

Delaware does recognise a gross negligence standard of liability to the extent such standard is provided for in the applicable partnership agreement. As a matter of market practice, the exculpation and indemnification provisions in a private equity fund’s limited partnership agreement typically carve out acts or omissions that constitute ‘gross negligence’ but under Delaware law, a partnership agreement could expressly exculpate or indemnify for such acts or omissions.

8 Other special issues or requirements

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

Restrictions on transfers and withdrawals, restrictions on operations generally, provisions regarding fiscal transparency, special investor governance rights on matters such as removal of the general partner or early dissolution of the private equity fund are all matters typically addressed in the provisions of the partnership agreement and will vary from fund-to-fund. Typically, the partnership agreement will require the consent of the general partner to effect a transfer of a partnership interest in a limited partnership. This requirement enables the general partner to maintain the fund’s compliance with applicable legal, tax and regulatory requirements and exemptions, as well as evaluate the appropriateness as a commercial matter of the proposed transferee. Although there is generally no right to withdraw from a Delaware limited partnership under the DRULPA, the limited partnership agreement for a private equity fund may provide for certain withdrawal rights for limited partners, typically only in limited circumstances for legal and regulatory reasons. Limited partners have the right to petition the Delaware Court of Chancery for withdrawal or similar equitable relief in egregious circumstances (for example, 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 (for example, 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 question 2). In addition, depending on where the redomiciled fund conducts its business, it may be required to obtain qualifications or authorisations to do business in certain jurisdictions. Any provisions of the partnership law of the state into which such domestication is effected that are otherwise inconsistent with the pre-existing governing agreement of such partnership should be reviewed and modified as necessary to ensure conformity with the applicable law. Consideration should also be given to the tax consequences of converting or redomiciling a limited partnership.

Certain aspects of US securities laws apply differently with respect to US and non-US private equity funds. For example, in determining whether a private equity fund formed in the US will qualify for exemption from registration under the Investment Company Act of 1940, as amended (the Investment Company Act), all investors,

both US and non-US, are analysed for determining the fund's compliance with the criteria for exemption. By contrast, in the case of a private equity fund formed in a jurisdiction outside the US, only US investors are analysed for the purposes of making that same determination (assuming certain other requirements are met).

The Securities and Exchange Act of 1934, as amended (the Exchange Act) and the regulations promulgated thereunder generally require that any issuer having 500 or more holders of record of any 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 private equity 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 private equity fund that qualifies as a 'foreign private issuer' and has fewer than 300 holders of equity securities resident in the US. A private equity fund that is organised outside of the US generally qualifies as a 'foreign private issuer' unless more than 50 per cent of its outstanding voting securities 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.

For purposes of generally accepted US accounting principles, to avoid consolidation of the financial statements of a private equity fund with its general partner, which is an issue of particular concern for some publicly listed private equity fund sponsors, the fund must provide its unaffiliated limited partners with the substantive ability to dissolve (liquidate) the fund (and appoint a third party as liquidator) or otherwise remove the general partner without cause on a simple majority basis (often referred to as kick-out rights).

9 Fund sponsor bankruptcy or change of control

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

Depending on the structure of a private equity fund and its general partner and the specific provisions of their operating agreements, the bankruptcy or insolvency of the ultimate sponsor of a private equity fund could result in the bankruptcy or dissolution of the private equity fund's general partner or advisor or of the fund itself. Moreover, such a bankruptcy or insolvency event could result in the inability of the sponsor to meet its funding obligations with respect to its capital commitment to the private equity fund. Depending on the terms of the private equity fund's partnership agreement, such a default could constitute a 'cause' event and thereby trigger rights of the limited partners to remove the private equity fund's general partner, dissolve the private equity fund itself or cause the forfeiture of all or a portion of the general partner's unrealised carried interest, or all of these. In addition to such 'cause' protections, a sponsor bankruptcy may result in a private equity fund's limited partners seeking to exercise the 'no-fault' remedies included in many partnership agreements, which often permit termination of the investment period, removal of the private equity fund's general partner and/or dissolution of the private equity fund. With respect to US bankruptcy law, a sponsor that has filed for reorganisation under chapter 11 of the bankruptcy code should still be permitted to operate non-bankrupt subsidiaries (including, for example, related private equity funds and their general partners) as ongoing businesses, although this raises a variety of operational issues including, for example, whether ordinary course investment and private equity fund management decisions must be approved by the bankruptcy court.

A change of control or similar transaction with respect to an institutional sponsor may also give rise to statutory and contractual rights and obligations, including a requirement under the Advisers Act for registered advisers that effective 'client' consent (namely, the private equity fund's limited partners or a committee thereof) be obtained for the transaction or rights of the limited partners, or both, under the private equity fund's partnership agreement to cancel the commitment period, dissolve the fund, remove the general partner or sue the general partner for a breach of a negative covenant against transfers of interests in the general partner, or both.

Regulation, licensing and registration

10 Principal regulatory bodies

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

The 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 the state level. Although almost all private equity fund managers fall within the definition of 'investment adviser' under the Advisers Act, most private equity fund advisers have historically been 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 private equity 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.

However, on 21 July 2010 President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which, among other things, eliminates the 'private adviser' exemption. Pursuant to Dodd-Frank, as of 30 March 2012, all advisers to 'private funds' (which generally includes private equity funds) will generally be required to be registered with limited exceptions, including:

- (i) advisers solely to 'venture capital funds';
- (ii) advisers solely to private funds with assets under management (AUM) in the US of less than US\$150 million (the private fund adviser exemption);
- (iii) certain 'foreign private advisers' (generally, advisers who are not holding themselves out to the public or advising registered funds, have no US place of business and have fewer than 15 US clients and investors in private funds, with AUM from such clients and US investors of less than US\$25 million); and
- (iv) certain 'mid-sized' advisers (with US\$25-100 million in AUM and that are required to be registered as an investment adviser of the state in which they maintain a principal office and place of business and, if registered, would be subject to examination as an investment adviser by the applicable securities commissioner, agency, or office).

Even if exempt from registration, advisers exempt under clauses (i) or (ii) above (exempt reporting advisers) will need to file certain basic information with the SEC.

On 22 June 2011, the SEC adopted rules to implement the registration requirements and exemptions described above. Notably, with respect to the private fund adviser exemption, the rules provide that an adviser would not be required to register as long as:

- it has no client that is a U.S. person except for qualifying private funds; and
- any assets managed by such adviser at a place of business in the U.S. are solely attributable to private fund assets valued at less than US\$150 million.

In determining whether assets are managed at a place of business in the US, the SEC would consider an adviser's principal office and place of business as the location where the adviser controls the management of private fund assets, although day-to-day management of certain assets may take place at another location. Advisers relying on this private fund adviser exemption are 'exempt reporting advisers', and will be subject to certain reporting and record keeping requirements as described below. An adviser with its principal office and place of business in the US must count all private fund assets, including those from non-US clients toward the US\$150 million in assets under management calculation. An adviser with its principal office and place of business outside of the US need only count private fund assets it manages at a place of business in the US toward the US \$150 million limit. 'Assets under management' are the securities portfolios for which an adviser provides continuous and regular supervisory or management services. An adviser provides 'continuous and regular supervisory or management services' with respect to a private equity fund from a place of business in the US if its US place of business has 'ongoing responsibility to select or make recommendations as to specific securities or other investments the fund may purchase or sell and, if such recommendations are accepted by the fund, the adviser's US place of business is responsible for arranging or effecting the purchase or sale. However, the SEC does not view merely providing research or conducting due diligence to be continuous and regular supervisory or management services at a US place of business if a person outside of the United States makes independent investment decisions and implements those decisions.

Pursuant to Dodd-Frank, private fund advisers that are required to register with the SEC will be subject to new reporting and record-keeping requirements as well as the existing reporting and record-keeping provisions of the Advisers Act. Dodd-Frank authorises the SEC to require registered advisers to maintain records and file such reports with the SEC as deemed necessary or appropriate in the public interest or for purposes of 'systemic risk' assessments made by the Financial Stability Oversight Council, a newly formed 10-member council chaired by the US treasury secretary, to identify and manage systemic risk in the US financial system. The records required to be maintained (and made available for SEC inspection and subject to SEC filing requirements to be prescribed) in respect of each private fund advised by a registered adviser will include information on the amount of assets under management; use of leverage, including off balance sheet leverage; counterparty credit risk exposure; trading and investment positions; valuations policies and practices; types of assets held; side letters; and trading practices of the fund.

Such private funds will also be required to maintain (and make available to the SEC) 'such other information' as the SEC, in consultation with the Financial Stability Oversight Council, determines is 'necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk'.

In connection with the implementation of these record keeping and reporting requirements, the SEC's recently adopted rules providing that exempt reporting advisers will not be required to register with the SEC but will be required to file, and periodically update, reports to the SEC by completing limited portions of Form ADV, part 1A, which requires disclosure of certain basic information with respect to the adviser, its activities and the private funds that it advises. The initial filing of Form ADV must be made by 30 March 2012 and such filing will be publicly available on the SEC's website. It must be amended at least annually, within 90 days of the end of the adviser's fiscal year, and more frequently under certain specific circumstances. The SEC is authorised to require an exempt reporting adviser to maintain records and provide reports, and to examine such adviser's records, which means an exempt reporting adviser's books and records are subject to SEC inspection. The SEC currently does not intend to perform routine examinations of exempt reporting advisers, but it retains the authority to do so in its discretion.

Exempt reporting advisers will not be required to file Form PF described below.

Starting as of 30 April 2013 (for private equity funds with a 31 December fiscal year-end), a registered private fund adviser with more than \$150 million of AUM will be required to file with the SEC a new 'Form PF', which requires disclosure of the adviser's AUM and certain basic identifying information regarding each private fund it advises, including gross and net asset value, gross and net performance, use of leverage, aggregate value of derivatives, a breakdown of the fund's investors by category (for example, individuals, pension funds, governmental entities, sovereign wealth funds), a breakdown of the fund's equity held by the five largest investors and a summary of fund assets and liabilities. Hedge fund advisers will also report information about fund strategy, counterparty credit risk and use of trading and clearing mechanisms. Required disclosure from registered advisers to private equity funds with more than \$2 billion AUM is more extensive, with additional focus on fund guarantees of controlled portfolio company obligations, leverage of controlled portfolio companies and use of bridge financing for controlled portfolio companies. Registered advisers to hedge funds with more than \$1.5 billion AUM will report on an aggregated basis information regarding exposures by asset class, geographical concentration and turnover, and for hedge funds with a net asset value of at least \$500 million, certain information relating to such fund's investments, leverage, risk profile and liquidity. For registered advisers that manage only private equity funds (as well as smaller hedge fund advisers), the form has to be filed annually, within 120 days of the fiscal year-end. Large hedge fund advisers must file Form PF on a quarterly basis within 60 days of the end of each fiscal quarter. Form PF filings will be confidential and such information will be exempt from requests for information under FOIA. However, the SEC is required to share information included in Form PF filings with the FSOC and in certain circumstances US Congress and other federal departments, agencies and self-regulatory organisations (in each case, subject to confidentiality restrictions).

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 a private equity 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 certain state regulators.

11 Governmental requirements

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

The offering and sale of interests in a private equity fund are typically conducted as 'private placements' exempt from the securities registration requirements imposed by the Securities Act of 1933, as amended (the Securities Act), the regulations thereunder and applicable state law. In addition, most private equity funds require their investors to meet certain eligibility requirements so as to enable the funds to qualify for exemption from regulation as investment companies under the Investment Company Act. Accordingly, there are no approval, licensing or registration requirements applicable to a private equity fund that offers its interests in a valid private placement and qualifies for an exemption from registration under the Investment Company Act.

As a general matter, private equity funds with 'significant' participation by US corporate pension plans (namely, 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 private equity fund's assets, valued at cost, invested in 'operating companies' as to which the private equity 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.

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

12 Registration of investment adviser

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

Absent an applicable exemption, a private equity fund's manager will be subject to registration as an investment adviser under the Advisers Act. Many managers of private equity funds satisfy the 'private adviser' exemption from registration for investment advisers with 14 or fewer clients (which typically counts a private equity 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 state laws as well. However, pursuant to Dodd-Frank, as of 30 March 2012, advisers to private equity funds will generally be required to be registered as investment advisers with limited exceptions. (See question 10, including with respect to recent legislative developments surrounding the 'private adviser' exemption and adviser registration more generally).

13 Fund manager requirements

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

There are no such requirements imposed by law on investment advisers. As a matter of market practice, a private equity fund's sponsor is typically expected to make a capital investment either directly in or on a side-by-side basis with the private equity fund (but see question 16 with respect to limitations on sponsor commitments in bank-sponsored private equity funds as a result of the Volcker Rule). 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 a private equity fund's management will be dictated by the demands of investors. If required to register as a broker-dealer with FINRA, a private equity fund sponsor would need to satisfy certain standards in connection with obtaining a registration (for example, no prior criminal acts, minimum capital, testing, etc).

14 Political contributions

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

In light of a number of US 'pay-to-play' scandals, the SEC adopted a broad set of rules in July 2010 aimed at curtailing such practices in the private equity industry. The rules, subject to certain de minimis exceptions, prohibit a registered adviser, as well as an exempt reporting adviser and a foreign private adviser (covered advisers), from providing advice for compensation to any US government entity within two years after the adviser or certain of its executives or employees

(covered associates) has made a political contribution to an elected official or candidate who is in a position to influence an investment by the government entity in a fund advised by such adviser. The rules also make it illegal for the covered adviser itself, or through a covered associate, to solicit or coordinate contributions for any government official (or political party) where the adviser is providing or seeking to provide investment advisory services. Advisers are also required to monitor and maintain records relating to political contributions made by their employees. The provisions of this new rule relating to political contributions took effect on 14 March 2011.

In addition to the SEC rule, certain US states (including New Mexico and New York) have enacted (or proposed) legislation and certain US public pension plans (including the New Mexico State Investment Council (SIC) and the New York State Common Retirement Fund (CRF)) have established policies that impose similar restrictions on political contributions to state officials by advisers and covered associates.

15 Use of intermediaries and lobbyist registration

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

The SEC's 'pay-to-play' rules discussed above also broadly prohibit a covered adviser from making any payment to a third party, including a placement agent, finder or other intermediary, for securing a capital commitment from a US government entity to a fund advised by the adviser unless, as recently proposed by the SEC, such placement agent is registered under section 15B of the Exchange Act and subject to 'pay-to-play' rules adopted by the Municipal Securities Rulemaking Board or FINRA, which are at least as stringent as the SEC 'pay-to-play' rules. The ban does not apply to payments by the adviser to its employees or owners. The provisions of this new rule relating to payments to intermediaries take effect on 13 June 2012.

Certain US states (including, Kentucky, Illinois, New Mexico and New York) have enacted (or proposed) legislation, and certain US public pension plans (including CRF and SIC) have established policies that prohibit the engagement or payment of placement agents by an adviser with respect to investment by the state's pension systems in a fund advised by such adviser. By contrast, other states, including Texas, and public pension plans such as the California Public Employees' Retirement System (CalPERS) and the Teacher Retirement System of Texas require disclosure of any placement fees paid (or to be paid) by an adviser in respect of an investment by the pension plan, rather than an outright ban on such payments.

In addition, California enacted legislation (effective as of 1 January 2011) that requires placement agents to register as lobbyists before soliciting investments from its two state-level public pension plans (CalPERS, California State Teachers' Retirement System (CalSTRS) and the University of California to the extent it is investing retirement (as opposed to endowment) assets) and prohibits them from receiving fees that are contingent on securing investments from the plans. The California law also requires registration by an adviser's own employees who are involved with the solicitation of investments from the California state pension plans, such as marketing or investor relations personnel, except where those employees spend at least a third of their time on investment-management activities. Advisers who retain third-party placement agents to solicit the California state pension plans or whose employees are covered by the lobbyist-registration law are considered 'lobbyist employers' under California law and are required to make certain public filings.

The California law also requires that placement agents and adviser employees who solicit local public pension plans in California comply with lobbyist reporting rules in the county, city or other jurisdiction where the plan is located.

In addition, various states and localities (including, for example, New York City) may have lobbying laws that effectively require investment advisers and their employees who solicit state and local pension plans to register as lobbyists.

16 Bank participation

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

In addition to Dodd-Frank's private fund adviser registration requirements discussed in question 10 above, the 'Volcker Rule' provisions of Dodd-Frank generally prohibit 'banking entities' from acquiring or retaining any ownership in, or sponsoring, a private equity fund. For purposes of the Volcker Rule, the term 'banking entity' means any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of the International Banking Act (such as a foreign bank that has a US branch, agency or commercial lending subsidiary) and any affiliate or subsidiary of such entities.

There are a number of exceptions to the basic prohibition on banking entities investing in or sponsoring private equity funds. In particular, banking entities are permitted to invest in private equity funds that they sponsor, provided that the investment does not exceed 3 per cent of the fund's total ownership interest or 3 per cent of the banking entity's 'Tier 1 capital', and provided that certain other conditions are met.

The Volcker Rule takes effect on 21 July 2012. Once the Volcker Rule is in effect, banking entities will have a two-year transition period to wind down, sell or otherwise conform their activities, investments and relationships to the requirements of the Volcker Rule, although they would not be prohibited from engaging in fund activities during that period. The US Federal Reserve Board may, upon a request by a banking entity, grant up to three separate one-year extensions to this transition period. In addition, Dodd-Frank includes a special provision to address the difficulty banking entities may experience in conforming investments in a private equity fund that qualifies as an 'illiquid fund', or a fund that as of 1 May 2010 was principally invested in, or was contractually committed to principally invest in, illiquid assets; and makes all investments pursuant to, and consistent with, an investment strategy to principally invest in illiquid assets. For such a fund, a banking entity may seek approval for an additional extension of up to five years.

Taxation

17 Tax obligations

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

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

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 private equity funds) is not treated as generating ECI.

The fund will also be required to withhold with respect to its non-US investors' distributive share of certain US source income of the fund that is not ECI (for example, 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 a private equity fund vehicle as a partnership for US federal income tax purposes is subject to certain rules regarding 'publicly traded partnerships' that could result in the partnership being classified as an association taxable as a corporation. To avoid these rules, funds are not commonly traded on a securities exchange or other established over-the-counter market and impose limitations on the transferability of interests in the private equity fund vehicle.

18 Local taxation of non-resident investors

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

Non-resident investors that invest directly in a private equity fund organised as a flow-through vehicle in the United States would be subject to US federal income taxation and return filing obligations if the private equity fund (or an entity organised as a flow-through vehicle into which the private equity fund invests) generates ECI (including gain from the sale of real property or stock in certain 'US real estate property holding corporations') (see question 17). In addition, all or a portion of the gain on the disposition (including by redemption) by a non-US investor of its interest in the fund may be taxed as ECI to the extent such gain is attributable to assets of the fund that generate ECI.

19 Local tax authority ruling

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

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

20 Organisational taxes

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

There are no significant taxes associated with the organisation of a private equity fund in the US.

21 Special tax considerations

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

Special consideration is given to structure the carried interest such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (namely, the recipient of the carried interest) and the investment manager (namely, the recipient of the management fee) into separate entities (see question 32).

Legislation has been introduced in Congress – versions of which have passed in the US House of Representatives – that, if enacted, 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 was introduced in the New York State legislature in 2010 that, if adopted, 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 (like New York State residents) being taxed at the applicable New York State personal income tax rate on such carried interest proceeds. It was also proposed in early 2009 to subject carried interest to the New York City unincorporated business tax. Although it does not appear that either such New York State or New York City proposal is being actively considered, it is unclear whether or to what extent any such legislation or similar legislation will become law.

22 Tax treaties

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

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

23 Other significant tax issues

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

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**24 Legal and regulatory restrictions**

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

To ensure that a private equity fund offering securities in the US will satisfy the requirements necessary to avoid registration with the SEC, a private equity fund sponsor will customarily conduct the offering and sale of interests in the private equity fund to meet a private placement exemption under the Securities Act. The most reliable way to do this is to comply with the 'safe harbour' criteria established by Regulation D under the Securities Act. Compliance with these criteria effectively necessitate, among other requirements, that each investor in the private equity fund be an accredited investor (which generally includes a natural person with a net worth of more than US\$1 million or income above US\$200,000 in the last two years 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. Under Dodd-Frank, the accredited investor standard's US\$1 million net-worth test has been revised to exclude the value of the investor's primary residence from the calculation of the investor's total assets and the amount of any mortgage or other indebtedness secured by an investor's primary residence from the calculation of the investor's total liabilities, except to the extent the fair market value of the residence is less than the amount of such mortgage or other indebtedness. Although the dollar threshold for this test has not been increased, by excluding the value of an investor's primary residence Dodd-Frank has effectively tightened the eligibility criteria. Dodd-Frank also authorises the SEC to modify the accredited investor test for individuals 'as appropriate for the protection of investors, in the public interest, and in light of the economy' and requires the SEC to conduct such a review every four years. To that end, the SEC recently added a timing provision to the revised net-worth test (effective 27 February 2012) designed to prevent investors from artificially inflating their net worth by incurring incremental indebtedness secured by their primary residence to acquire assets that would be included in the net worth calculation. Under the timing provision, if a borrowing occurs in the 60 days preceding the purchase of securities in an exempt offering and is not in connection with the purchase of the primary residence, the incremental indebtedness must be treated as a liability for the net worth calculation, even if the value of the primary residence exceeds the aggregate amount of debt secured by the primary residence.

To ensure that a private equity fund will satisfy the requirements necessary to avoid regulation as an 'investment company' under the Investment Company Act, each investor in the fund will typically be required to represent that it is a 'qualified purchaser' as defined in section 2(a)(51) of the Investment Company Act. In the event that not all of a private equity fund's investors are qualified purchasers, then the fund may still qualify for an exemption (the 3(c)(1) exemption) by limiting the number of investors to not more than 100 (all of which must still be accredited investors and with respect to which certain 'look through' attribution rules apply). (A 'qualified purchaser' generally includes a natural person who owns not less than US\$5 million in investments, a company acting for its own account or the accounts of other qualified purchasers that owns and invests on a discretionary basis not less than US\$25 million in investments and certain trusts.) 'Knowledgeable employees' (namely, executive officers and directors of the sponsor and most investment professionals involved with the private equity fund) are ignored for the purposes of the foregoing requirements. If the sponsor of a private equity fund is a registered investment adviser under the Advisers Act, then in certain circumstances each investor may need to represent that it is a 'qualified client' as defined under the Advisers Act. A 'qualified client' generally includes a natural person or company with a net worth exceeding US\$1.5 million or that has US\$750,000 under management with the adviser, although under Dodd-Frank the SEC is required, by 21 July 2011 and every five years thereafter, to adjust these dollar amounts for inflation. To that end, on 12 July 2011, the SEC issued an order raising the net worth and assets under management thresholds for a 'qualified client' to US\$2 million and US\$1 million, respectively (effective 11 September 2011 with a grandfather provision for existing investors) and proposed certain additional amendments, including an exclusion of the value of an investor's primary residence from the net worth test (corresponding to the changes to the 'accredited investor' test referenced above).

A private equity 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 calendar days after the first sale of securities. Form D sets forth certain basic information about the offering, including the amount of securities offered and sold as well as whether any sales commissions were paid to any broker-dealers and, if so, the states in which purchases were solicited

by such broker-dealer. In addition to federal securities law compliance, most states also have similar notice-filing requirements. Since 16 March 2009, every Form D filed with the SEC must be filed electronically on the new Form D. With respect to the filing deadline for the new Form D, the SEC has confirmed its previously stated interpretation that a 'sale' is 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 private equity fund receives the investor's subscription agreement and not necessarily as late as the closing date.

25 Types of investor

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

Other than compliance with certain aspects of the anti-money laundering provisions of the USA PATRIOT Act (the Patriot Act) discussed in question 28, as a general matter there are no such restrictions other than those imposed by applicable securities laws described above or which may arise under the laws of other jurisdictions. Sponsors of private equity funds may choose to limit participation by certain types of investors in 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 a private equity fund in investments by the private equity fund in certain regulated industries (for example, airlines, shipping, telecommunications and defence). (See question 16 with respect to recently enacted restrictions on bank holding companies investing in private equity funds.)

26 Identity of investors

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

There is generally no requirement to notify the state of Delaware or the SEC as a result of a change in the identity of investors in a private equity fund formed in Delaware (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, 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 private equity fund. In the event of a change of the general partner of a Delaware limited partnership, an amendment to the fund's certificate of limited partnership would be required to be filed in Delaware and such change would need to be accomplished in accordance with such limited partnership's partnership agreement. Additionally, a private equity fund that makes an investment in a regulated industry, such as banking, insurance, airlines, telecommunications, shipping, defence, energy and gaming, may be required to disclose the identity and ownership percentage of fund investors to the applicable regulatory authorities in connection with an investment in any such company.

27 Licences and registrations

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

Generally, the sponsor of a private equity fund in the US would not be required to register as a broker or dealer under the Exchange Act as they are not normally considered to be 'engaged in the business'

Update and trends

- Preferential terms (for example, as to co-invest/fees) for larger investors or first closers.
- Managed account arrangements for largest investors (sovereign wealth funds, large public pension funds).
- Pressure by investors for 100 per cent management fee offset and 'back-ended' carry formula.
- Investors pushing strongly for no-fault divorce rights over cancellation of investment period, dissolution and GP removal.
- Massive increase in regulation in the private fund industry, principally due to Dodd-Frank (including registration and enhanced reporting for most private equity fund advisers and restrictions imposed by the 'Volker Rule') but also at the state and federal level due to the 'pay to play' pension fund scandals.
- Previously introduced legislation that would tax carried interest from private equity funds as ordinary income has not passed, but the prospects for future legislation in this area are unclear.

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

28 Money laundering

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

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

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

Currently, there are no regulations in effect that would require the disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor. If an investment adviser to a private equity fund is registered under the Advisers Act, the 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. (See also question 10 for disclosure obligations under Form PF.)

Exchange listing**29 Listing**

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

Because of certain adverse tax consequences arising from status as a 'publicly traded partnership' and the difficulty that such a listing would impose on being able to establish an exemption from registration under the Investment Company Act, private equity funds do not typically list on a securities exchange in the US (see also question 17). The applicable listing requirements would be established by the relevant securities exchange.

30 Restriction on transfers of interests

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

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

Participation in private equity transactions**31 Legal and regulatory restrictions**

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

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

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

In addition, depending on the composition of a private equity fund's investors, the private equity 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 private equity fund will qualify as a VCOC, which generally entails having at least 50 per cent of the private equity fund's assets, valued at cost, invested in 'operating companies' as to which the private equity fund obtains 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.

32 Compensation and profit-sharing

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

Depending on the state in which a private equity fund is formed and operates, there may be tax advantages to forming separate entities to receive the carried interest and management fee (and other fee) payments in respect of the fund and other unique structuring requirements. For example, funds whose manager has a place of business in New York City typically use this bifurcated structure. Additionally, as noted in question 21, legislation has recently been introduced in Congress – versions of which have passed in the US House of Representatives – that, if enacted, would result in typical carried interest distributions being 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.

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

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



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