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Dechert partnered with *Getting the Deal Through* and *Law Business Research* on their annual Market Intelligence Private Equity Guide. The Guide invites leading practitioners to reflect on evolving legal and regulatory landscapes and global trends. Private equity experts from Dechert's Corporate, Finance, Financial Services and Tax practices in London provided the UK content which is in Q&A format and is reproduced below.

Please click here to access the full Market Intelligence Private Equity Guide.

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1. What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Jonathan Angell (JA): The private equity market in the UK and, indeed, much of Europe and elsewhere, is multi-layered. UK private equity sponsors operate very successfully across a range of sectors at all levels, from seed and venture capital funding, to large (multibillion pound sterling) buyouts. It is therefore difficult to generalise, without being caught out by the inevitable exceptions.

Consistent with trends in the global private equity market, the UK market remains buoyant, sustained by a combination of historically low interest rates, an extended economic growth run, supportive credit markets supplying cheap deal financing, and bountiful fundraising that is keeping 'dry powder' at high levels. However, those high levels of dry powder also mean that there remains great competition for deals, particularly the most attractive assets (with deal origination therefore remaining key).

Private equity managers have been responding in a number of ways. First, the trend towards specialisation continues apace: managers perceive a clear advantage in attracting money from investors and in appealing to sellers and management teams. Secondly, PE fund managers continue to develop creative deal structures, this includes making acquisitions based on industry or market differentials, creating vertically integrated portfolio companies (instead of horizontal combinations), and building a portfolio company from scratch (with a hand-picked management team). We are also seeing continued geographic diversification and expansion (in large part to gain exposure to faster-growing regions).

2. Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?

JA: As mentioned above, sourcing and origination remains key differentiators in the UK M&A market, not merely for private equity sponsors.

High-quality opportunities are in relatively short supply and, when they do arise, are often subject to intensely competitive demand (exacerbated by the high levels of dry powder). For private equity sponsors, this demand is currently heightened because many trade or strategic buyers have large amounts of cash to deploy and are also often able to increase their offer to reflect anticipated synergy benefits. Counter to that, as well as having the mountain of capital represented by dry powder, private equity sponsors have multiple sources of debt. Understandably, many private equity sponsors continue to look for opportunities outside or beyond competitive auction processes (which is easier said than done).

In terms of private equity buy-side activity trends, we are seeing fewer 'traditional' buyout transactions (in absolute and relative terms), and an increase in other approaches, particularly creative solutions such as portfolio acquisitions; buy-and-build strategies; and alternative investment structures and transactions, including minority stakes, corporate control transactions, club and consortium deals (including private equity and trade combinations), and growth investments.

3. What were the recent keynote deals? And what made them stand out?

JA: Two recent deals stand out. The acquisition of Japan-based Toshiba Corporation's NAND flash memory and solid-state drive business, now known as Toshiba Memory Corp, by a purchasing consortium led by US

private equity firm Bain Capital that also included SK hynix Inc (a Korean memory chip maker), Apple Inc and Dell Technologies. Valued at US$18 billion, according to Thomson Reuters, it's the fourth-largest private equity-backed M&A deal since the financial crisis of 2008.

The second deal I would mention is the sale of Albéa SA to PAI Partners by an affiliate of Sun European Partners (the European adviser to Florida-based private-equity firm Sun Capital Partners). Albéa SA manufactures plastic packaging products for the beauty and personal care market.

4. Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? How are those challenges evolving?

JA: On the first issue, the answer depends, in large part, on the size of deal. Venture capital investments and mid-market private equity transactions tend to have a stronger UK nexus and are often either domestic UK or with limited cross-border involvement. Although somewhat a generalisation, a larger target company or business is more likely to have international operations (or plans) and therefore require cross-border expertise. In addition, many private equity funds are targeted at a specific jurisdiction or region.

One trend in this respect, undoubtedly driven by investor appetite, but also by the ongoing challenge of deal origination and sourcing mentioned earlier, is the proliferation of funds focused on different geographies (emerging markets being a prime example) and non-traditional private equity areas (such as credit funds).

With regard to the second question, at its most basic, a cross-border element adds a layer of complexity. Multiple jurisdictions will almost certainly affect the tax structuring and add a layer of complexity to the debt and acquisition financing (both in terms of any debt push-down and security). The challenge is ensuring that this does not become a problem to the overall deal either substantively or logistically. There is, simultaneously, a positive and a negative aspect to being a UK-based legal adviser. On the plus side, English law is (and, notwithstanding Brexit, should continue to be) a significant 'export' of the UK, generating many cross-border transactions and opportunities. At the same time, the 'Anglo- Saxon deal methodology' that English legal advisers typically adopt may not be familiar (or universally welcome). Whether the transaction involves working with our non-UK offices across the globe or, in jurisdictions where we do not have an office, with independent law firms (where we maintain good relationships), the objective is to identify any local law requirements quickly, and in a collaborative manner. These requirements can often be procedural or items of detail and easily solved, but, if left to linger, can become more problematic.

5. What are some of the current trends in financing for private equity transactions? Have there been any notable developments in the availability or the terms of debt financing for buyers over the past year or so?

John Markland (JM): The past year saw borrowers continuing to take advantage of the highly liquid lending market conditions, with many borrowers turning to the European market for institutional loans in preference to high-yield bonds and 'Yankee Loans' (also known as US TLBs). The market demand (outweighed by the volume of funds flowing into the market) was such that a significant number of borrowers used such debt to refinance (or reprice) existing debt, take out existing high-yield bonds with term loans or to upsize existing facilities and return value to the sponsors through dividend recapitalisations.

The pricing advantage of these term loans over high-yield bonds was not the sole driver behind this trend. The market is increasingly tolerating very limited to no call protection on these loans in contrast to the non-call restrictions on high-yield bonds.

With bond-style financial covenants (including covenant-lite and covenant-loose structures) increasingly accepted in the European market, borrowers have sought to negotiate more flexible (or, depending on one's view, looser) covenants.

Borrowers have negotiated the ability to incur an increasing amount of incremental or additional debt using fixed basket amounts and ratio- based tests. Restrictions on borrowers making distributions to investors have increasingly been relaxed through lowering applicable leverage ratio thresholds and using consolidated net income (or excess cash flow combined with other sources), often accompanied by a 'starter basket' providing immediate capacity, as a basis for calculating such permitted payments.

As long as market conditions remain so favourable to them, borrowers can be expected to continue to negotiate for greater flexibility and the loosening of covenants in their financing documentation.

6. How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

Jane Scobie (JS): From a tax perspective there continues to be an increased policy focus on transparency, disclosure and ensuring that businesses pay what is considered to be a fair amount of tax in the correct jurisdictions. In the UK many of the current and proposed legislative provisions have been derived from its commitment to implement measures derived from the OECD's Base Erosion and Profit Shifting project (BEPS). In terms of the structure and financing of private equity deal structures both the anti-hybrid legislation (which seeks to counteract 'hybrid mismatches' arising from entities or instruments that are treated differently for tax purposes in different jurisdictions) and the new interest barrier rules (that further limit the deductibility of corporate interest by reference to UK taxable EBITDA) continue to influence typical structures. There is also a continued specific concern among policy makers as to whether the current international tax regime taxes the digital economy in a fair and efficient way. This has led most recently to the publication in the UK of a government paper setting out various proposals for discussion including the introduction of a wider royalty withholding tax in circumstances where payments are made to low tax jurisdictions in connection with sales to UK customers (ie, regardless of where the payer is located). Further, recent examples of the UK's commitment to attempt to ensure fairness and parity between

UK and non-UK investors include the proposals to extend the charge to capital gains tax and corporation tax on chargeable gains realised by non-residents from UK property (expected to be in force from 6 April 2019).

7. What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?

JA: The typical public view is still that private equity generates significant returns for the wealthy at the expense of other stakeholders in the businesses in which they invest: they see private equity as willing to sacrifice long-term sustainability in return for short-term gains. Given that general public sentiment, some

politicians and policymakers inevitably seek to garner support by pledging to clamp down on excess private equity profits.

The UK private equity industry, supported by the British Private Equity & Venture Capital Association and Invest Europe, has, over a period of time, presented a more complete picture. The Walker Guidelines/Guidelines Monitoring Group is an example of these efforts. It has two aims: first, to increase transparency and disclosure; and, second, to provide data that demonstrates private equity's contribution to the UK economy. Although much progress has been made, there is still work to be done to improve understanding of the sector.

Traditionally, shareholder activism has not played a significant role in the UK and Europe (at least in comparison to the US). There have been a couple of notable exceptions recently in the UK (such as Electra Private Equity where, following activist pressure, Electra terminated its 40-year relationship with its investment manager) and reports suggest that investor activism has been rising in the UK (and Europe) over the past few years.

8. What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

JA: Exits have remained a focus for many UK private equity funds. We have seen a mix of exit routes, predominantly trade, or secondary private equity, sales, but also initial public offerings (IPOs). Buyers' strong appetite for assets means that there remains an attractive environment for private equity firms to exit. IPO activity (private equity-related or otherwise) remains down and, given the uncertainty inherent in an IPO, we expect most exits to continue to be by way of trade sale (including secondary buyout).

A recent notable example was the sale of Coveris Holdings SA, a premier global packaging manufacturer and a portfolio company of Sun Capital Partners, in connection with the sale of its Global Rigid Business to Lindsay Goldberg LLC for a total consideration of €700 million.

9. Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

Mikhaelle Schiappacasse (MS): Investment across a range of PE strategies remains strong, notwithstanding Brexit, as investors look for returns in the continuing low-yield environment. The recent market data I have seen indicates that investors are focusing on established managers, which is leading to the concentration of capital in the hands of fewer managers, while first-time funds compete for less capital. There continues to be a broad preference by continental European investors, in particular, for onshore European fund structures.

Focus is on sponsors with verifiable excellent outperformance, and particularly those that have strong performance in niche sectors. Market sources show that the leading strategies continue to be buyout, venture capital and growth, targeting technology, industry and financial services. We've seen a marked increase over the past few years of sponsors targeting more focused investment strategies, in an attempt to achieve greater differentiation and to target investors whose investment strategies have become more granular. One example is private equity sponsors moving into the credit fund space, whether that's in order to be complementary to their private equity activities or not. I expect that this market will continue to grow.

Investors are certainly looking at fund terms more closely and negotiating these before deciding to commit. Investor demands tend to centre on fees, transparency, co-investment rights, governance controls and, increasingly, on ESG. There is continuing pressure on fees, with instances of managers agreeing to management fees on invested capital throughout the fund's life, although there is a residual concern from some investors that this could push managers into making more rushed investment decisions. The other issue that is getting increased investor and regulatory focus is the use of fund-level credit lines, particularly where these are used other than for bridging purposes.

Larger asset allocators are reviewing performance in existing funds much more carefully before re-upping than was the case previously. This is to ensure that terms are robust, and is also part of narrowing down the number of general partner relationships. The larger investors continue to explore single account mandates and access to co-investment rights. The co-invest pieces generally attract markedly lower fees, where we are seeing increased pressure, than a fund investment, and we see much greater flexibility on fees for single accounts than fund investments, even taking into account side-letter rebates. These also permit investors to dictate investment restrictions and structure more closely, and depending on the structure can reduce regulatory costs.

10. Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

MS: There's really no such thing as a typical fundraising process – it is iterative, with the circle of potential investors gradually increasing before focusing back on key target investors. There are a few questions that any sponsor has to pose at the outset and those questions have not really changed, notwithstanding increased regulation or changes in the broader economic climate.

The first questions centre on when the right time is to fundraise: are there restrictions in existing fund documents that prevent you from raising a new fund? Where are you in deploying the committed capital you still have? Are you coming into the market off a good (or great) exit track record? What will your investors think about capacity issues if you focus on a fundraising, leaving aside successor fund restrictions?

Once the client has decided that the time is right, we typically work with them on a teaser with key outline terms and a fund structure or, in certain circumstances, a more fully developed term sheet. The structure will have been tested and discussed from a commercial, legal, regulatory and tax perspective, to make sure that it appeals to the target investor base, but does not involve an unnecessary level of regulation, complexity and cost. The nuances inherent in that analysis have changed in the past few years, but, as before, the aim is to have a structure that fits both sponsors and investors.

Testing the market may take two weeks, two months or more. Once the sponsor has identified its cornerstone investors or otherwise gained some traction, we then move to full form documentation. If there is a regulatory approval process, then that will drive the timetable; if not, then we work with the sponsor and service providers to get draft documentation into a data room as quickly as is sensibly possible.

The next key step is investor negotiations. Principal-to-principal discussions normally precede our re-engagement in the process, but we then focus on agreeing amendments to constitutional documents – typically a limited partnership agreement – to the extent required, or on negotiating side-letter terms. Investors increasingly have a list of points that they intend to raise (the Institutional Limited Partners Association has done a good job of framing some of those discussions) and large investors tend to have their preferred form of side letter. The points usually break down into commercial points (eg, key man or fee

provisions, or restrictions around post-investment period drawdowns or recycling), regulatory points (such as restrictions on certain types of investment or leverage) and tax points (such as ensuring that there is adequate tax reporting and compliance). We are frequently seeing relatively detailed negotiations with one or two cornerstone investors before other first- close investors engage, particularly where those cornerstone investors are known in the market to be prepared to test terms.

The key concern currently is what happens with UK-authorised sponsors once Brexit has played out. With a negotiated Brexit currently looking less likely, the possibility of achieving equivalence from a financial services perspective is receding. As such, sponsors are focusing more on 'Brexit-proofing' their fund structure from a management and a marketing perspective. This includes considerations such as the jurisdiction of the fund and the AIFM and how the UK based sponsor can best undertake discretionary management or provide advice in respect of the fund's assets.

11. How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

MS: There is, unsurprisingly, an increase in supervision of private equity and other fund sponsors. That is entirely consistent with the direction of travel in the asset management industry in general.

Private equity sponsors located in the UK are typically regulated by the UK Financial Conduct Authority (FCA) as either investment managers (and there are a couple of types of this depending on size of funds, the investment strategy and whether there is another management entity in the fund structure) or advisers.

From a pan-European regulatory perspective, we have gone from having no supranational regime in the closed-ended space to having a number of regimes, including lighter-touch regimes for venture capital sponsors, for example, to enable them to navigate around some of the more stringent requirements of the AIFMD. There has to date been limited take-up on these specialist regimes.

The more traditional adviser-only model that was prevalent in the market a decade or so ago is less common than it was with more managers taking licenses authorising them to manage funds' assets on a discretionary basis.

The rules of the FCA, which frame the conduct of private equity (and other) sponsors, are based on EU legislation. The FCA has taken a pragmatic approach to implementation of those provisions, such as making it easy to register funds for marketing in the UK or permitting application of proportionality principles to remuneration rules.

There is no reason currently to expect the existing regimes or rules to change in the near term in the UK as a result of Brexit.

Aside from dealing with ongoing concerns regarding Brexit, sponsors have had to tackle the Markets in Financial Instruments Directive (MiFID II) which came into force at the beginning of this year and the General Data Protection Regulation, which came into force in May of 2018. At the fund structuring level sponsors are also having to give consideration to the OECD's BEPS framework, particularly as it relates to treaty shopping. Implementation of the Senior Managers and Certification Regime is also fast approaching. With Brexit looming and the risk of a no-deal exit, the industry will be facing a number of practical and existential issues relating to, among others, jurisdiction of operation, licensing, market access and staff recruitment and retention.

12. What effect has the AIFMD had on fundraising in your jurisdiction?

MS: First, there has been an indirect impact on the types of structure that private equity sponsors now look at, because many investor jurisdictions, particularly in continental Europe, have pushed onshore European structures and these structures can easily be marketed in the UK and Europe under the pan-European marketing passport. Second, the FCA has been much clearer than other regulators in providing guidance around marketing issues under the AIFMD and facilitating registration for marketing of non-European fund structures in the UK. Smaller private equity sponsors that now seek to become fully authorised under the AIFMD probably now face greater operational challenges in how they structure their own business because of the need to separate business functions more strictly than was previously required.

The AIFMD is now raising a different set of challenges as the advent of Brexit will result in the UK constituting a third country under the European implementation of AIFMD – meaning that without a negotiated deal of some kind it will become more difficult for UK sponsors to raise or continue to manage European funds or market to Europe- based investors.

13. What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

JS: Current challenges for private equity managers continue to derive from the measures implanted from the OECD's BEPs project. Such measures include the potential application of the UK's new anti-hybrid rules to both pre-existing and new cross-border structures that in many instances will lead to a denial of UK deductions where previously they would have been available. Coupled with the consequences of the new interest barrier rules, this has led to a revaluation of the usefulness of particular hybrid instruments and hybrid entities that were historically commonly used as part of a typical private equity investment structure.

Favourable capital gains tax treatment for carried interest remains available in the UK in certain circumstances, although a new higher special rate of 28 per cent has recently been introduced for carried interest (as compared to the standard 20 per cent rate for capital gains). In addition, consideration needs to be given to the 'income-based carried interest' regime that, broadly, looks to the weighted average investment holding period of fund investments in determining whether capital gains treatment should be available. An average investment holding period of at least 40 months is generally required for full capital gains tax treatment, with an average holding period of less than 36 months leading to full income tax treatment. These rules have introduced additional complexity and uncertainty for managers, and have obviously restricted the range of funds in respect of which tax-efficient carried interest is available.

14. Looking ahead, what can we expect? What might be the main themes in the next 12 months for both private equity deal activity and fundraising?

JA: Brexit (and the increasing potential of a No-Deal Brexit) continues to create uncertainty. Confidence remains fragile, and other global events may give further pause for thought. 2019 will be an interesting year!

Given the decline in the sterling exchange rate, some assets may be more attractive to acquirers who are non-sterling-denominated private equity funds. Once the markets have adjusted to the post-Brexit environment, and as an overall trend, we expect private equity activity to remain at high levels.

15. What factors make private equity practice in your jurisdiction unique?

JA: The UK private equity market is perhaps second only to the US, not just in terms of size and scale, but also for its well-earned reputation for quality and innovation. It is, and seems set to remain, notwithstanding Brexit, the largest hub for private equity in Europe. This results in high levels of expertise, knowledge and efficiency throughout UK private equity industry law (from sponsors to lawyers and other advisers). When coupled with English law's predominance owing to its international reputation as a stable, established legal and judicial system, there is a demand for UK private equity transaction methodologies, and for English law far beyond the geographic boundaries of the UK.

16. What should a client consider when choosing counsel for a complex private equity transaction in your jurisdiction?

JA: Focus on the individuals in the team.

• Who will work on your deal? At Dechert, we typically work in small, partner-led teams. The people you meet at the outset are the people who will do your work, and the partners remain hands-on throughout.

• There is no substitute for experience. Our private equity experts across the globe provide sensible, commercial (as much as legal) advice, know what matters (and what doesn't) and can anticipate issues (resolving them before they become problems).

• You need to get on with your counsel; we work hard to become part of your 'team'.

17. What interesting or unusual issues have you come across in recent matters?

JA: Each of our current matters immediately becomes the most interesting, it is impossible to single out any one! Every deal poses its own challenges – and hopefully rewards as those challenges are overcome. Equally, every client is unusual, and even unique. There is a thrill to advising a client with whom you have worked for many years where you actually feel a part of their business, just as there a real excitement to getting to know a new client and helping them over the finish line for the first time.

Content published and produced in November 2018.

Dechert's Private Equity Practice

Overview

Dechert is among the most active law firms in the private equity industry. The practice began more than 30 years ago when it advised venture capital firms on fund formation and transactions. Our global team of more than 250 lawyers represents all types of private equity sponsors and other private investment firms, including sovereign wealth funds and family offices, and their portfolio companies, as well as institutional and corporate investors looking to invest in private equity funds. In every phase of the private equity investment life cycle, we help clients accomplish their investment objectives.

Recent Transactions

Examples of recent transactions on which Dechert advised include:

- **SK hynix Inc.** as part of a consortium in connection with the completed **US$18 billion** acquisition of Japanese-based Toshiba Corporation's NAND flash memory and solid-state drive business, representing **one of the largest private equity-backed acquisitions globally in the past three years**, according to *Thomson Reuters.*
- **Chrysaor** on its acquisition of a package of assets in the UK North Sea from Shell UK Limited and its affiliates for more than **US$3.8 billion**.
- **Sun European Partners** on the completed **US$1.5 billion** sale of its portfolio company Albéa S.A., to PAI Partners.
- **Wyndham Worldwide Corporation** on the completed sale of its European vacation rental business to private equity firm Platinum Equity for **US$1.3 billion**.
- **Sun European Partners** on the completed **€700 million** sale of the Global Rigid Packaging business of Coveris Holdings S.A., to Lindsay Goldberg LLC.

Awards and Recognition

LegalWeek THE BRITISH LEGAL AWARDS 2018	**M&A Deal of the Year (Large Deal)** (2018)
The Deal AWARDS EUROPE 2018 WINNER EUROPEAN M&A LAW FIRM	Winner '**European M&A Law Firm of the Year**' and '**Deal of the Year**' (2018)
realdeals PAN-EUROPEAN LEGAL ADVISER OF THE YEAR THE PRIVATE EQUITY AWARDS 2018 FINALIST 2018	Dechert was shortlisted and a finalist for the Private Equity Awards by *RealDeals* (2018)
PRIVATE DEBT INVESTOR	Law Firm of the Year in Asia, Europe and the U.S. by *Private Debt Investor* (2018)

About Dechert

Dechert is a global law firm.

Focused on sectors with the greatest complexities, legal intricacies and the highest regulatory demands, we excel at delivering practical commercial judgment and deep legal expertise for high-stakes matters.

In an increasingly challenging environment, clients look to us to serve them in ways that are faster, sharper and leaner without compromising excellence.

We are relentless in serving our clients – delivering the best of the firm to them with entrepreneurial energy and seamless collaboration.

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* Dechert has in Jeddah and Riyadh an association with the Law Firm of Hassan Mahassni.

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Dechert lawyers acted on the matters listed in this presentation either at Dechert or prior to joining the firm.

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