LEXOLOGY
Getting The Deal Through

Private Equity in the United Kingdom

2022 Edition

Dechert LLP

Private Equity in the United Kingdom

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

Please click here to access the full 2002 edition 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 year 2021 was extremely busy, with private equity (PE) activity in the UK in 2021 at its highest level since the 2008 global financial crisis. Compared to 2019 (the most recent pre-pandemic figures), 2021 deal values were up 15 per cent and volumes up 20 per cent. KPMG's UK mid-market PE review reported that 1,545 PE deals, worth a total of £159.2 billion, were completed in 2021 (up from 1,117 in 2020 and 1,246 in 2019). This increased level of activity was seen across the board – mid-market PE investment was at the highest level ever recorded and there were an unprecedented 12 deals valued at over £1 billion. British companies were attractive targets for global PE firms in 2021, with many considered to be undervalued as a result of Brexit and the covid-19 pandemic (among Jonathan Angell John Markland other factors). As the Washington Post put it: 'Private equity firms feasted on the cheap UK stock market for as long as they could in 2021.' However, there has been a decline in the first half (H1) of 2022 compared to the record-breaking peak in 2021 (deal volumes and values are down approximately 19 per cent and 16 per cent respectively); although activity is still higher than pre-pandemic levels. The impact of Brexit and the pandemic is less, but there are still clouds on the horizon for the UK market: including the situation in Ukraine, inflation and the cost of living crisis, global supply chain disruption and so on. As a counter to that, many consider that there could be a fresh shopping spree in the UK in H2 2022, given the falling UK stock market and the low GBP exchange rate, which is attractive to US dollar, euro and other non-sterling funds (all of which still have much dry powder).

Within that broader context, the PE market in the United Kingdom and, indeed, much of Europe and elsewhere, remains multi-layered. UK PE sponsors have historically operated very successfully across a range of sectors at all levels, from seed and venture capital funding to large (multi-billion pound sterling) PE transactions, including take-privates. As noted above, 2021 was the year of take-privates (five of the 10 biggest deals were public-to-privates) and of largecap buyouts.

Historically, the United Kingdom has been the largest private equity market in Europe, with a long and proud history in welcoming private equity sponsors who are looking to fund-raise and invest there. That remained the case in 2021: the UK was the largest PE market in Europe, when measured by both volume and value of deals. The UK also, therefore, has a well-established legal system and regulatory footprint to deal with various outcomes and challenges that the private equity industry may face from time to time. The UK PE industry has a strong and robust system and has created new asset classes and credit funds that have adapted to the leveraged buyout system.

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: The most common types of PE transactions in the UK centre around leveraged buyouts (in the form of share and/or asset acquisitions), take-private transactions, refinancings, flotations and bolt-on transactions. In 2021, we noticed a marked increase in the number of bolt-on transactions – a low-risk strategy, which supports the growth of existing platform businesses. As a related point, we have seen financial sponsors continuing to back existing investments by moving them into new funds and continuation vehicles.

We expect traditional PE sponsors will continue to seek innovative investment structures to allow the deployment of capital at attractive valuations, but with a greater degree of down-side protection (such as earn-outs, preferred equity or convertible debt).

In the past, the PE industry in the United Kingdom has adapted and driven value creation through its portfolio companies in highly focused and more innovative ways – and there is every reason to believe that it will continue to do so. This will undoubtedly give rise to conventional 'add-on' acquisitions, but also platform deals where PE sponsors rebrand an asset from the outset with a new management team. This will most commonly be achieved through carve-outs of entities from large corporates.

Pre-pandemic, PE firms started, and have continued, to establish long-term funds and/or deploy long-term capital. This extends the firm's period between its fundraising efforts and also changes its investment life cycle. Most obviously, this will assist with investments and assets that take longer to mature. It may also help change the perception of PE firms in the mind of some public shareholders, which may help PE firms to obtain shareholder approval on take privates.

Non-traditional PE funds (such as sovereign wealth funds, pension plans and family offices) have continued their shift from a minority position to a control or lead-investor-type role on direct investments in the PE space. This trend has been driven by the desire to have greater control, reduced fees and greater returns on invested capital, particularly in the traditional PE space. This shift in focus has, in turn, created additional competition for traditional PE funds. The result has been increased variation in the deployment of capital by these non-traditional PE investors across the capital structure.

The UK PE M&A landscape continues to be generally favourable to sellers (both PE and non-PE). Recent trends include: (1) an increase in the number of sale processes being run as competitive auctions on a tight timetable; (2) increased prevalence of pre-emptive bids in competitive processes; (3) further growth in the use of warranty and indemnity (W&I) insurance, often with low residual seller liability; and (4) shorter seller liability time periods, in many cases regardless of whether W&I insurance is being used.

Unsurprisingly, some sectors have been more attractive to PE investors than others: TMT and, business services continue to be favourites (more than half of mid-market deals in H1 2021 were in these sectors, perhaps driven by remote working and the pandemic. Health care and financial services also performed strongly. Environmental, social and governance (ESG) considerations, including diversity and inclusion, is likely to remain a key focus, not least in terms of demand from limited partners, consumers and employees, and PE firms are taking a more proactive approach in the area.

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

JA: A couple of recent deals stand out.

The UK's third and fourth largest supermarket chains were both bought by private equity investors in 2021. ASDA was acquired by TDR Capital and the Issa brothers in the Spring for £6.8 billion, while WM Morrisons Supermarkets PLC was acquired by Clayton, Dubilier and Rice in the Autumn for £9.98 billion. The acquisition of ASDA was the UK's largest leveraged buyout in nearly 14 years, even though Walmart only got £100 million more in sale proceeds than it paid for the supermarket chain in 1999.

These two deals are evidence of the 'cheap' UK stock market, and undervalued UK companies. Some (politicians and trade unions being prime examples) have as a result labelled the current market as the 'UK for sale'.

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 PE 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 crossborder 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, is the proliferation of funds focused on different geographies (emerging markets being a prime example) and non-traditional PE 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, continues 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 that are 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 acquisition finance market slowed this year with the war in Ukraine, and the capital markets took an early summer break. Rising interest rates, inflation, commodity prices and the prospect of recession unnerved investors and lenders alike. But the mid-market has been buoyant this summer.

On the face of it there is plenty of liquidity in the market, offered both by banks and by debt funds. Debt funds in Europe have been consolidating their position in the market, showing preparedness to tread ever-deeper into jumbo deals, including where banks and bond-holders are reluctant. But at the same time the market is steeling itself for rising interest rates and lenders are building their restructuring capabilities.

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

Daniel Hawthorne (DH): 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 United Kingdom, a number of new legislative provisions have derived from a commitment to implement the recommendations of the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. In terms of the structure and financing of PE 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 interest barrier rules (that further limit the deductibility of corporate interest by reference to UK taxable earnings before interest, taxes, depreciation and amortisation) continue to influence typical structures. The anti-hybrid rules, in particular, create uncertainty in a number of respects. Further limitations on the availability of double tax treaty relief from withholding tax are another indicator of the direction of travel (whether by reason of the application of the 'principal purpose test' under the BEPS multilateral instrument or more robust beneficial ownership requirements established by EU courts in the 'Danish cases').

Although the tax regime applicable to PE in the UK remains stable and the incumbent government has signalled an intention to simplify the tax system where possible, the UK remains committed to the OECD's BEPS objectives and is expected to continue to support global measures designed to address perceived imbalances in the global tax system, all of which may contribute to additional tax complexity, at least in the short to medium term. This is shown by the UK committing to the proposed Global Anti-Base Erosion (GLoBE) rules and minimum 15 per cent corporation tax rate, which may impact upon private equity portfolio companies. On the other hand, the positive recent introduction of the Qualified Asset Holding Company vehicle for alternative fund structures (to rival the intermediate investment vehicles commonly utilised in non-UK fund structures) signals a clear intention on the part of the government to improve the competitiveness of the UK as a jurisdiction in which to establish funds and is hopefully only the first of a number of such positive measures.

Reform of corporate governance in the UK was kick-started by the UK government in late 2017 when it published a 'response' setting out 12 reforms that the government intends to make to the UK corporate governance regime. Areas to be reformed include, for example:

i. Addressing significant shareholder dissent on executive pay;

ii. Broadening the role of remuneration committees;

iii. Use of long-term incentive plans;

iv. Encouraging investors to make full use of their existing powers on executive remuneration;

v. Improving directors' understanding of the 'enlightened shareholder value' model; and

vi. Improving transparency.

These reforms have been implemented in large part since their announcement by various bodies, from government to HM Revenue & Customs, the Financial Reporting Council and, for the asset management industry, by the Investment Association, which published its Good Stewardship Guide in February 2021.

More recently, in May 2022, the UK government published a response to its 2021 consultation on restoring trust in audit and corporate governance in the UK. The response proposes various reforms, including in relation to corporate reporting, the accountability of company directors and the scope and purpose of audits. It is expected that these changes will be introduced over the next few years.

With respect to the financial services industry, including fund management, wide ranging reforms will take place following the enactment in April last year of the Financial Services Act (FSA) 2021. A number of its provisions are in force as at August 2022, but it will only be in the coming few years that the full set of comprehensive changes and reforms will be felt by the fund management industry.

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 (stoked by some politicians, trade unions and the like) is still that PE generates significant returns for the wealthy at the expense of other stakeholders in the businesses in which they invest. The boom in acquisitions by non-UK PE firms has also generated commentary to the effect that PE is draining UK businesses – the returns generated are flowing out of the country, to international investors, and leaving the UK. The UK PE industry, supported by the British Private Equity & Venture Capital Association and Invest Europe, has, over a period of time, presented a more complete picture.

Shareholder activism has steadily increased in the UK public markets. ESG is a crucial factor in this regard. On the plus side, activist shareholders taking positions in UK-listed companies may drive corporate break-ups, creating carve-out or acquisition opportunities for PE firms.

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: The year 2021 showed a slight recovery in exit volumes, but anecdotal evidence suggests there has been a significant drop-off in PE exits during H1 2022 (down significantly on 2019).

In H1 2022, given the uncertain capital markets and the pull-back by trade acquirers, there has been a significant increase in consolidation (assets being moved into new funds and continuation vehicles) and secondary buyouts, with some reports indicating that secondary buyouts have been the primary exit route in this period. The highest proportion of exits were in business services, whereas consumer goods and services have fallen – reflecting the current volatility in that sector.

Two recent notable examples are:

- The exit of Apax Partners, Warburg Pincus, the Canada Pension Plan Investment Board and the Ontario Teachers' Pension Plan from Inmarsat (which the consortium had taken private less than two years prior for US$3.4 billion). Viasat acquired Inmarsat for US$7.3 billion; and
- The sale by Quilvest of Phaidon, a professional services firm, to a global investor consortium led by Further Global Capital Management.

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?

Thiha Tun (TT): Fundraising in 2022 is looking like a world of two halves. H1 2022 continued the strong year set by 2021, with fundraising in the US matching that of H1 2021 according to PitchBook data, although globally, the amount raised declined from US$789 billion to US $645 billion according to Bain & Co's midyear update. Buyout funds in particular saw a steep decline, raising US$138 billion in H1 2022 compared to US$284 billion in H1 2021. Predictions that 2022 would match or even exceed 2021's total funds raised have been revised downwards by most market observers as macro headwinds such as rising inflation and interest rates and declining GDP growth in various countries and regions temper investor appetite. There are already clear signs that sponsors are pivoting towards defensive strategies as they reposition themselves and their portfolio companies to weather a potential recession.

In the light of this, fundraising activity is generally likely to favour investors although sponsors with the strongest track records should be able to stand their ground and not dilute terms too much. The greater challenge for sponsors will be whether they have a strong enough bench to offer a compelling strategy to investors in the light of global macro-economic uncertainties and geopolitical tensions. The largest global sponsors are likely to have the bench strength as are niche sponsors of stressed or distressed strategies, but that will still leave many sponsors unable to raise new funds during H2 2022 and into 2023.

Last year, we noted three noticeable trends: secondaries transactions (particularly GP-led secondaries); 'retailisation' of private funds and ESG investing.

As an update:

- Secondaries transactions in H1 2022 remained strong. According to Evercore data, transaction volume was US$53 billion in H1 2022 compared to US$48 billion in H1 2021. Dry powder remains high at US$94 billion as at June 2022, which is slightly up on June 2021. The balance between LP stakes and GP-leds has shifted somewhat in favour of LP stakes with deal value up from US$18 billion to US$26 billion whereas for GP-leds, deal value has dropped to US$27 billion compared to US$30 billion. 2022 is being predicted to be a strong year for secondaries transactions.
- 'Retailisation' has continued apace, with more sponsors tapping retail and semi-retail investors. In the UK, we are finally seeing modest interest in the UK Long-Term Asset Fund, but no interest in using the UK Long-Term Investment Fund ((LTIF) probably because the UK government has made no indication that it would revise the UK LTIF Regulation in line with the proposed revised EU ELTIF Regulation, which contains several notable improvements over the original EU ELTIF Regulation, thus making the UK LTIF less attractive than its EU counterpart).
- ESG: As we noted last year, there have been concerns among market participants of 'greenwashing' and that certainly became a reality in 2022. On both sides of the Atlantic, firms have been accused by regulators of 'greenwashing' and exaggerating the ESG credentials of their funds. BNY Mellon was fined US$1.5 million for mis-statements and DWS (the asset management division of Deutsche) is facing investigations by the UK and

German regulators for overstating the amount of assets under management that it deemed ESG-compliant. Some industry participants are predicting ESG funds will be the next big mis-selling scandal to hit the asset management industry.

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?

TT: There is really no such thing as a typical fundraising process and time frames can vary dramatically.

At the time of writing, it is difficult to predict whether average time frames for raising a fund will be materially longer than in previous recent years. Anecdotally, there are signs of average time frames being longer in the case of certain asset classes such as real estate and ESG and some sponsors think that overall time frames are likely to be somewhat longer as they head into 2022 year end and 2023 due to some LPs holding back on commitments while they assess the impact of interest rates and inflation on asset values.

The key fundamentals of a successful fundraising remain the same: keep close to your investors and give them what they want; use a fund structure, jurisdiction and terms that are familiar to and acceptable by your investors; and present your investors with a great pipeline of deals. In the covid-19 and, possibly, post covid-19 context, we may add that, if one is looking for a speedy fundraising, it might be easier to close successor funds with well-known limited partners, rather than target new strategies with new investors.

Having said this, there are basic steps all sponsors need to consider when launching a fund.

The first question centres 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. Here we would, of course, now take into account Brexit and the related regulatory challenges, as well as the rapidly changing international tax regulation and best practices.

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. We are also seeing an increasing use of the 'strategic limited partner' concept to attract investors who are not just large investors but who are seen by the sponsor as bringing an expert perspective or other strategic value to the table. Where you have strategic limited partners, it is important to pay attention to the most-favoured nation clause in your side letter, since the strategic limited partner concessions will be bespoke and should not be a general most-favoured nation term.

In terms of governing law, due to Brexit, but also other regulatory and tax considerations, UK fund managers might choose to use EU onshore fund vehicles. It might be required, or simply more appropriate, to subject certain agreements or constitutional documents to the local foreign law, while the management or advisory agreements as well as deal documentation usually remain governed by English law. Such choice of law clauses specifying English law as the governing law of contractual and non-contractual obligations should continue to be recognised by EU courts, based on Rome I and Rome II EU Regulations. In the United Kingdom, the necessary corresponding legislation was passed in March 2019, ensuring that substantively same rules will continue to apply in the UK in relation to the choice of foreign law.

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

TT: There has, unsurprisingly, been an increase in supervision of PE and other fund sponsors. That is entirely consistent with the direction of travel in the asset management industry in general.

PE sponsors located in the United Kingdom 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.

The rules of the FCA, which frame the conduct of PE (and other) sponsors, are currently still based on EU legislation. The FCA has, historically, taken a pragmatic approach to implementation of those provisions, such as making it easy to register funds for marketing in the United Kingdom or permitting application of proportionality principles to remuneration rules. However, with the FSA receiving Royal Assent on 29 April 2021 and coming into force, the next few years will see significant changes to existing UK financial services regulations as well new laws and regulations coming into effect that will impact the fund management industry as a whole, including private fund managers and sponsors. The most significant items of new legislation under the framework of the FSA during 2022 that are relevant to investment firms are:

- The Overseas Funds Regime, which came into force on 23 February 2022; and
- The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2022, which came into force on 19 July 2022.

As a result, we expect the FCA to publish amendments to its Handbook of Rules and Guidance and introduce new chapters and sourcebooks.

Regulators remain acutely wary of the misuse of crypto assets. In June 2022, HM Treasury published the outcome of and proposed response to its 2021 consultation on the proposed amendments to the UK Money Laundering

Regulations 2017. Following approval by Parliament, the amendments came into force on 1 September 2022. There are a number of proposals related to Virtual Asset Service Providers.

In addition, the Law Commission published, on 28 July 2022, proposals for reform of laws to take into account digital assets. Key proposals include:

- Explicitly recognising a distinct category of personal property under the law, which is better able to accommodate the unique features of digital assets. The distinct category is provisionally called 'data objects';
- Options for how this distinct category of personal property could be developed and implemented under current law; clarifying the law around ownership and control of digital assets; and
- Clarifying the law around transfers and transactions involving digital assets.

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

TT: Inconsistencies in the manner in which AIFMD was implemented by EU countries in terms of the interpretation of 'pre-marketing', 'marketing' and the regulatory notification processes have been harmonised through the Cross-Border Distribution of Collective Investment Undertakings Directive (Directive (EU) 2019/1160) and the Regulation on facilitating Cross-Border Distribution of Collective Investment Undertakings Regulation (Regulation (EU) 2019/1156), collectively, CBD/R. The UK has not adopted CBD/R as UK law and nothing in the Financial Services Act 2021 refers to the CBD/R. Accordingly, now that the UK is a third country for the purposes of the AIFMD, UK managers will be in the same position as managers from other third countries such as the US or Singapore or Japan. Marketing to EU investors will need to be made on the basis of the National Private Placement Regimes (NPPR) of EU countries under article 42 of the AIFMD. A pre-condition to accessing the NPPR under article 42 is that there is in place a cooperation agreement in place between the UK and the relevant EU 27 member states. On 1 January 2021, several memoranda of understanding came into effect, including a multilateral memorandum of understanding between the FCA and EU and EEA National Competent Authorities covering, among others, investment services and asset management activities. Accordingly, UK managers can raise funds from EU/EEA investors on the basis of an article 42 private placement, albeit with certain changes likely to come about due to the CBD/R. For example, the CBD/R contains a recital that states that national rules cannot disadvantage EEA AIFMs as compared to non-EEA AIFMs. As a result, a number of EU countries have introduced some form of 'levelling-up' of their NPPRs to bring them in-line with the CBD/R rules on pre-marketing and discontinuation of marketing.

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?

DH: Current challenges for PE managers continue to derive from the measures coming out of the OECD's BEPs project. Such measures include the potential application of the UK's anti-hybrid rules (and the wider EU measures introduced under Anti-Tax Avoidance Directives) to both pre-existing and new cross-border structures, which, in many instances, will lead to a denial of UK deductions where previously they would have been available. Coupled with the consequences of the 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 PE investment structure. From an international point of view, attention is focused on the increased entity substance rules introduced in commonly used low tax jurisdictions such as the Channel Islands and the Cayman Islands, and the possibility that the new rules may encourage further structures onshore. The recent introduction of the Qualified Asset Holding Company vehicle will hopefully further encourage the use of UK structures.

Favourable capital gains tax treatment for carried interest remains available in the UK in certain circumstances, although a higher special rate of 28 per cent applies to 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. It remains a lingering concern that capital gains tax rates will, at some point, be more closely aligned with income tax rates. At the time of writing, no such changes have been announced but it would be no surprise if capital gains tax rates (including the rate applicable to carried interest) rise in the short to medium term.

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: The current economic situation (with rising inflation and interest rates and a weak GBP) has undoubtedly replaced the covid-19 pandemic (which, in turn, had overtaken Brexit) as the key external influence on PE transactions in the UK. However, (successful) PE sponsors and investors have adjusted to this changing dynamic on several occasions and we expect that to continue.

By way of example, we anticipate that market volatility may lead to a continued reduction in IPOs (only 11 companies listed on the main market in London in H1 2022, compared to 40 listings in the same period in 2021).

ESG and D&I will continue to be extremely important – particularly in the UK as compared to some other jurisdictions – perhaps accentuated by the covid-19 pandemic. We are seeing factors such as diversity, carbon footprint and regular ESG reporting become significant factors in assessing potential investment opportunities.

Looking forward, on the plus side there remain the significant amounts of ‘dry powder’ available to PE funds. But, by way of counter- balance, it is not unbridled optimism: there is uncertainty caused by war in Ukraine and the economic challenges in the UK, which may slow the rate of dealmaking. The rising interest rates will inevitably result in leveraged buyouts becoming more expensive – and/or requiring a bigger equity cheque – with many dealmakers in the UK already pricing in at least a 5 to 7 per cent increase in inflation in their valuation models for 2022.

Deal teams with the deep sector expertise required to understand the effects of these various factors on their target industry and the ability to execute transactions in distressed environments will be best placed to take advantage of the opportunities presented in the market.

Dechert's Private Equity Practice

Overview

Dechert has been at the forefront of advising private equity firms for 35+ years, and in 2021 was ranked among the top law firms for U.S. Buyouts and Global Buyouts by *Mergermarket*. With more than 300 private equity and private investment clients, we have unique insights into how the industry has evolved and where it's going next. Our globally integrated team of more than 350 private equity lawyers advises private equity, private credit and other alternative asset managers on flexible solutions at every phase of the investment life cycle.

Recent Transactions

Examples of recent private equity transactions on which Dechert advised include:

- **Brookfield** on its majority investment in a €500 million joint venture to acquire, develop and manage logistics and industrial assets throughout Iberia.
- **Court Square** on the acquisition of Edge Technology Group by its portfolio company Thrive.
- **Endless** on the acquisition of Hovis, a leading UK-based bakery brand.
- **Further Global Capital Management** on (i) the acquisition of a majority stake of Progeny, a leading professional advisory platform; and (ii) the acquisition of AA Ireland Limited.
- **GIC** on (i) the US$27 billion sale of Refinitiv by a consortium to London Stock Exchange Group plc; and (ii) the £6.9 billion bid by the Fortress Investment Group-led consortium to acquire Wm Morrison Supermarkets plc.
- **Mid Europa Partners** on the acquisition of Pigu and the combination of Pigu and Hobby Hall Group.
- **Nordic Capital** on the acquisition of Duco Technology Limited, a leading Software as a Service (SaaS) provider to financial institutions.
- **One Equity Partners** on the acquisition of BRUSH Group, a leading independent provider of equipment, services and solutions for electrical power generation and distribution.
- **Quilvest** on the sale of Phaidon, a professional services firm, to a global investor consortium led by Further Global Capital Management.

Awards and Recognition

The LEGAL 500 UNITED KINGDOM	Ranked as a leading firm for **Private Equity: Transactions – High-value Deals (£250m+)** (2023)
PitchBook	Ranked among one of **the most active law firms for private equity debt deals** (2022)
THE PRIVATE EQUITY AWARDS 2021 realdeals	Named "**Pan-European Legal Adviser of the Year**" (2021)
Mergermarket An Acuris company	Ranked **#5 for U.S. Buyouts** and **#10 for Global Buyouts** by deal value in *Mergermarket*'s Global & Regional League Tables – Legal Advisors Report (2021)
REFINITIV	Ranked among **the top law firms for value and number of Glob Private Equity and LBO deals** (2020)
Law360 GROUP of the YEAR PRIVATE EQUITY	Named '**Practice Group of the Year**' for Private Equity (2019)

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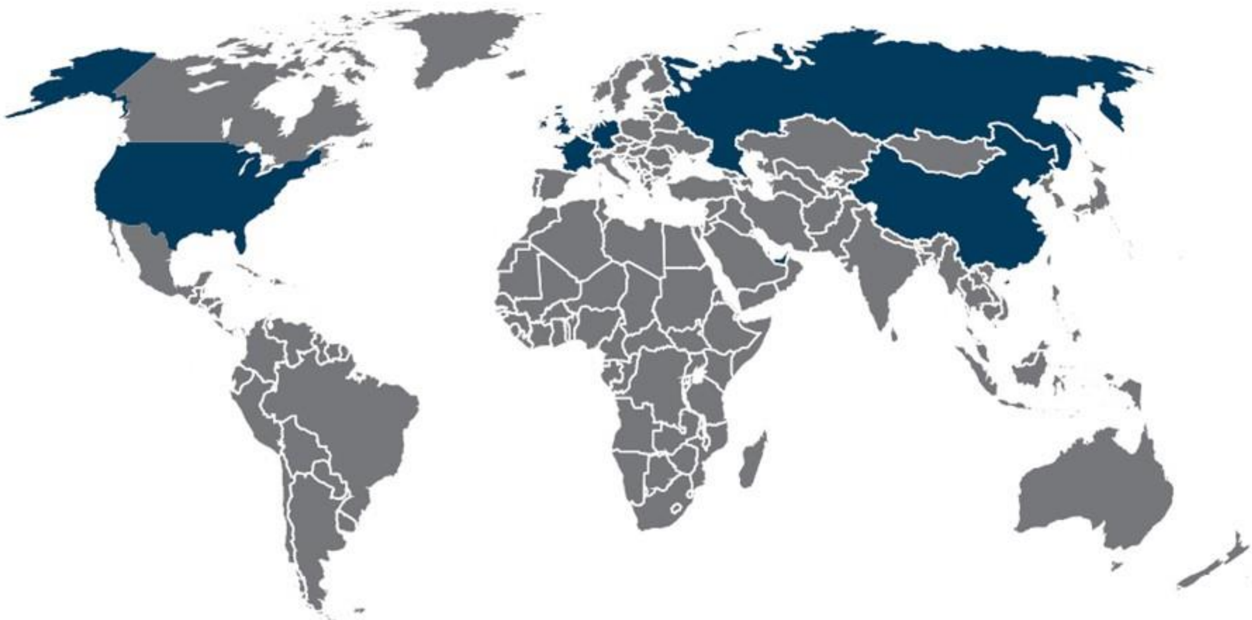

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