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The International Comparative Legal Guide to:

Private Equity 2017

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A practical cross-border insight into private equity

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Chapter 30

United Kingdom

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1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions? Have you seen any changes in the types of private equity transactions being implemented in the last two to three years?

A broad range of private equity ("PE") transactions are carried out in the United Kingdom ("UK"), among the most common are leveraged buyouts, refinancings, flotations and follow-on sales, trade sales, secondary buyouts and bolt-on deals.

A degree of uncertainty at a macroeconomic level (compounded by political upheaval due to Brexit and the US Elections and ongoing structural issues in the Eurozone) have affected the UK PE market in 2016. Deal value and numbers were down from 2015 – levels of exits also went down and, on the buy-side, PE houses suffered from lofty purchase price multiples and competition from strategic acquirers ripe with cash and seeking growth opportunities.

1.2 What are the most significant factors or developments encouraging or inhibiting private equity transactions in your jurisdiction?

The UK is a free market economy, which is particularly welcoming to businesses. It has a well-established legal system and enduring political stability offers reliability and comfort to investors. It is yet unclear how this landscape will be affected, or even reshaped by Brexit. The Government may enact measures to off-set some of the perceived pitfalls of Brexit or implement other measures to strengthen London as a business hub. It will be crucial that stability continues and that the UK remains able to attract and retain talent.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction? Have new structures increasingly developed (e.g. minority investments)?

PE transactions are usually structured using a holding company ("Topco") and an indirect wholly-owned subsidiary of Topco ("Bidco"). Topco is commonly owned by the PE fund and management, as majority and minority shareholders, respectively. Topco would frequently take the form of an offshore vehicle, commonly UK tax resident.

Bidco's primary role is to acquire and hold the target's shares and it may also act as borrower under the debt facilities. For tax and/or financing-related purposes (including avoiding shareholders needing to enter into intercreditor agreements), it is common to have one or more intermediate holding companies inserted between Topco and Bidco.

For inbound investments, Bidco is typically a private limited liability company resident for tax purposes in the UK. Non-UK tax resident Bidcos have historically been common for certain asset classes (particularly property related investments) although the market may change in that regard in light of current UK tax authority consultations on bringing non-resident companies holding interests in UK residential real estate into corporation tax and in light of the outcomes and implementation of the OECD's BEPS project. The jurisdiction of incorporation of Bidco can vary based on the desired corporate flexibility and may be onshore or offshore – many PE investments prefer non-English incorporated companies as there is a 0.5% UK stamp duty on share transfers in English incorporated companies.

2.2 What are the main drivers for these acquisition structures?

There are a number of factors which affect the acquisition structure adopted in PE transactions. These drivers include: (i) the tax requirements, capacity and sensitivities of the PE sponsor, management and target (see also section 9 below); (ii) the finance providers' requirements; and (iii) the expected profile of investor returns. In recent times, we have seen investors taking a more pro-active approach in seeking to influence the choice of structure.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

PE investors typically use small proportions of equity finance to subscribe for ordinary or preferred ordinary shares in Topco. The balance is generally invested as shareholder loans (often structured as payment-in-kind loan notes issued by Topco), preference shares or offshore hybrid instruments (such as Luxembourg-preferred equity certificates). These shares and other instruments are together known as the "institutional strip". Management will generally subscribe for ordinary shares in Topco representing between 5% and 15% (save for in very large buyouts where this may be less), commonly referred to as "sweet equity". In some buyouts, key senior management

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with sufficient funds to do so may also be permitted (or, in most instances, required) to invest in the institutional strip.

Senior management are usually expected to make sufficient financial investment in the target group to ensure their interests remain aligned with the PE investor and that they remain incentivised to create further value – the amount of this investment typically varies depending on whether the deal is the first investment by management or a secondary buyout.

Other key personnel may be invited to participate in management incentive plans or to become additional employee shareholders.

Carried interest (a share of the fund's overall profits) is typically structured through a limited partnership, with executives or their vehicles as limited partners. The carried interest limited partnership is, in turn, often a special limited partner in the fund limited partnership. It is typically calculated on a whole-of-fund basis (i.e. the entitlement arises after investors have received a return of their drawn-down capital, plus any preferred return accrued and if certain other pre-agreed hurdles are cleared).

UK tax resident participants in the carried interest may prefer to receive carried interest through interests falling within the terms of a 2003 Memorandum of Understanding between the British Venture Capital Association and the Inland Revenue (now HM Revenue & Customs) relating to carried interest. Participants based or working in the UK will also wish to ensure that the carried interest is respected as such and is not recharacterised as income-based or otherwise as a disguised investment management fee (see section 9 below).

2.4 What are the main drivers for these equity structures?

Management incentivisation, structural subordination of equity and investor financing, ease of return of funds to investors, and tax considerations (see question 9.1 below) generally feature as main drivers for these structures.

2.5 In relation to management equity, what are the typical vesting and compulsory acquisition provisions?

Transaction documents will invariably include provisions enabling the PE fund to compulsorily acquire a manager's shares on termination of his/her employment with the relevant portfolio company.

Documentation will usually include good leaver/bad leaver provisions, which will determine the amount payable to the departing manager. These provisions come in many forms but will frequently define "good leaver" by reference to specific circumstances (death/disability, retirement over statutory retirement age, long-term illness, termination without cause, etc.) with all other circumstances constituting a "bad leaver".

A "good leaver" will commonly obtain the higher of cost and, subject to vesting provisions, fair market value for his shares while a "bad leaver" may expect to receive the lower of fair market value and cost.

The relevant documentation may also include vesting provisions that will regulate the proportion of shares for which the departing employee will be entitled to the "good leaver" price (i.e. higher of cost and fair market value) by reference to the length of the period from buyout to termination. Vesting may be straight-line or stepped and full vesting may typically occur after a period of between three and five years, although the lengthening of investment holding periods is likely to stretch vesting.

2.6 If a private equity investor is taking a minority position, are there different structuring considerations?

Generally in the UK, it is relatively rare for private investors to take minority positions. However, where they have, the structuring considerations are generally the same – there may just be competing structuring interests between the minority private equity investor and the controlling investor.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

PE sponsors and management will typically enter into a shareholders' agreement to govern their relations as shareholders in the portfolio company. This will likely include, among other provisions: (i) covenants from management with regard to the conduct of the business of the portfolio company; (ii) extensive veto rights for the PE sponsor; (iii) restrictions on the transfer of securities in the portfolio company; and (iv) provisions regarding further issuances of shareholder equity/debt.

In addition, the constitutional documents may include governance arrangements, particularly with regard to the transfer of shares. In the UK, constitutional documents of UK incorporated companies are publicly available, so many PE sponsors prefer to keep sensitive information in the shareholders' agreement.

3.2 Do private equity investors and/or their director nominees typically enjoy significant veto rights over major corporate actions (such as acquisitions and disposals, litigation, indebtedness, changing the nature of the business, business plans and strategy, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

PE investors normally enjoy significant veto rights over major corporate, commercial and financial matters, although thresholds are commonly set to ensure that day-to-day decisions can be taken by management.

These veto rights will typically be split between director veto rights and shareholder veto rights. Provisions may be included enabling director veto rights to be elevated to shareholder veto rights where, for example, concerns arise as to directors' duties and conflicts of interest.

If private equity investors take a minority position, whilst having customary "corporate-related" veto rights, they sometimes also negotiate a set of "business-related" protections (so-called "reserved matters"), depending on the level of their minority interest.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

Veto rights will generally be respected by English courts, but may be found to be void if they constitute an unlawful fetter on any statutory powers of an English company or are contrary to public policy. Generally, appropriate structures can be put in place to ensure that customary veto rights are effective. More often than not, if a decision is taken or transaction entered into irrespective of a veto, redress will be in the form of compensation/damages as opposed to injunctive relief or specific performance since absent provisions in the articles and given the principle of ostensible authority, such decision or transaction will stand.

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A shareholders' agreement is likely to be entered into to ensure that agreed veto arrangements would be upheld at the shareholder level. Such an agreement may also obligate the shareholders to procure that certain actions are taken (or not taken) by the relevant target group companies.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

Unless voluntarily assumed by a PE sponsor, the PE investor itself is not subject to fiduciary or other duties under English company law to the minority shareholders (but see question 3.6 below for potential liability as shadow director). Board nominees generally owe duties to the company, but may, in limited circumstances, owe duties to shareholders (for example, regarding information disclosure).

Certain duties may also be owed if: (i) the portfolio company is insolvent or verging on insolvency; or (ii) if a specific special relationship (for example, principal and agent) is established between the nominee directors and the shareholders.

Shareholders may be entitled to (i) bring derivative actions on behalf of the company against the nominee directors (often as a last resort), or (ii) commence an unfair prejudice petition if the affairs of a UK company are being, or have been, conducted in a manner that is unfairly prejudicial to shareholders generally or one or more shareholders – both are relatively rare (especially in a PE context).

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

Subject to customary legal reservations and save to the extent that they contravene statute or are contrary to public policy, a well drafted shareholders' agreement in relation to a UK company will generally be respected. However, if the group structure includes companies from other jurisdictions, the impact of the laws of those jurisdictions will need to be considered.

Certain provisions in the shareholders' agreement will require careful consideration to ensure that they are enforceable – for example:

(a) subject to the (i) Rome I Regulation on the law applicable to contractual obligations ((EC) 593/2008), and (ii) Rome II Regulation on the law applicable to non-contractual obligations ((EC) 864/2007), a well-drafted governing law and jurisdiction provision will generally be respected; and

(b) driven by public policy, non-compete/non-solicit provisions must be reasonable – this will be assessed in the context of all the relevant circumstances and the focus should be ongoing no further than is required in order to protect the legitimate interests of the PE sponsor and its investment in the portfolio company.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies under corporate law and also more generally under other applicable laws (see section 10 below)?

PE investors must ensure that nominee directors are eligible to act as directors, including in particular that they are not disqualified by statute (e.g. under the Company Directors Disqualification Act 1986, by being an undischarged bankrupt).

In the context of being entitled to nominate directors, PE investors ought to be aware that, in certain circumstances, they may be construed as "shadow directors" under s. 251 Companies Act 2006 ("CA"), if the nominee directors are accustomed to act according to the directions and instructions of the PE fund. If construed as shadow directors, the PE investor would be treated as a director of the portfolio company and directors' duties would apply to it.

Nominated directors risk incurring liabilities if they breach their directors' duties (including their statutory duties under ss. 170–178 CA) and may face the risk of clawback action for certain decisions made during certain periods of time if the company is insolvent or verging on insolvency.

PE investors will typically seek to mitigate the impact of the above risks through (i) indemnities from the portfolio companies (subject to certain limitations under the CA), and (ii) directors' and officers' insurance policies (at both the portfolio company and PE sponsor level).

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Such directors must be mindful that, although they are nominee directors, their duties are generally owed to the company itself and not to the party nominating them or other shareholders.

The CA (s. 175) imposes a duty on a director to "avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company". This applies to "situations" rather than a conflict of interest arising in relation to a transaction or arrangement with the company (which are governed by separate sections of the CA). Such an actual or potential conflict of interest may arise, for example, with respect to (i) the nominating PE sponsor, or (ii) the directors' other directorial positions.

Where such a conflict exists, the duty to avoid conflicts of interest will not be infringed if the matter has been authorised by the directors, and, accordingly, appropriate authorisations should be put in place at the earliest opportunity. The constitutional documents of the company should be checked to ensure the directors are able to provide such authorisation.

In addition to the duty under s. 175 CA referred to above, directors are required to declare their interests in transactions or arrangements which are proposed but have not yet been entered into by the company (s. 177 CA) and in relation to existing transactions or arrangements that the company has already entered into (s. 182 CA).

The ability for a director to participate in the decision-making process with regard to any transaction in which he has declared an interest will be governed by the company's articles of association. A director will not be in breach of the general duty under s. 177 CA to declare an interest in a proposed transaction if he acts in accordance with any provisions of the company's articles dealing with conflicts.

S. 185 CA permits a general notice to be given in relation to conflicts in certain circumstances, thereby avoiding the need to give repeated notices where the conflict arises from the same facts or circumstances.

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4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including competition and other regulatory approval requirements, disclosure obligations and financing issues?

The timing for transactions is largely affected by regulatory approvals (mainly competition and sector-specific approvals) and the preparation of financials (particularly given the prevalence of locked-box-pricing mechanisms in PE transactions (see question 6.1 below)). Another important factor is whether the transaction is run as an auction with multiple potential buyers or on an exclusive basis. The former tend to be quicker given the tension created by the auction itself and the seller's ability to impose terms.

4.2 Have there been any discernible trends in transaction terms over recent years?

The M&A landscape remains generally favourable to PE sellers in the UK. Recent trends include: (i) the continuing prevalence of the "locked-box" consideration structure; (ii) an increase in deals involving warranty and indemnity insurance; (iii) continuing limited warranty protection from PE sellers; and (iv) reducing limitation of liability periods. That said, PE ability to follow these trends, especially as regards limiting their liability, is becoming more and more a function of their bargaining power, which in turn is a reflection of the asset for sale.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

In public-to-private transactions involving UK companies, the City Code on Takeovers and Mergers ("Takeover Code") will usually apply, imposing restrictions and rules that must be complied with throughout the transaction (and which are more restrictive than private transactions).

Recent changes to the Takeover Code in particular that may impact PE buyers include: (i) significantly increased obligations with respect to disclosure of financing arrangements (including their publication on websites); (ii) the imposition of a strict timetable for the announcement of offers under the "PUSU" regime (requiring the announcement of a firm offer to make a bid within a 28-day period (unless the Panel on Takeovers and Mergers grants an extension) in specified circumstances (e.g. where there has been a leak followed by an announcement identifying the potential bidder)). In the context of a private equity leveraged transaction it may be a challenge to arrange financing so as to achieve the necessary "certain funds" within such 28-day period; (iii) the abolition of break fees in most cases (see question 5.2 below) reduces PE sponsors' ability to recover costs (including due diligence costs) of preparing for a bid; and (iv) the inability (in most cases) to achieve "preferred" or "exclusive" bidder status, again exposing PE houses to potential costs that cannot be recovered from the target.

Some of these issues are discussed further in *The International Comparative Legal Guide to: Mergers & Acquisitions 2016* in the chapter entitled "Divergence / A Game of Two Halves?"

5.2 Are break-up fees available in your jurisdiction in relation to public acquisitions? If not, what other arrangements are available, e.g. to cover aborted deal costs? If so, are such arrangements frequently agreed and what is the general range of such break-up fees?

As a general rule, "offer-related arrangements", including break fees, inducement fees or other arrangements having a similar or comparable effect are not allowed in relation to public acquisitions pursuant to the Takeover Code. Nevertheless, the Panel on Takeovers and Mergers will normally allow break fees in limited circumstances; including where: (i) a non-recommended offer has been announced and an inducement fee is payable to a white knight as long as it does not exceed 1% of the target's value; and (ii) the target announced a formal sale process (and the fee is subject to the 1% cap) or is in financial distress and is seeking a bidder.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

"Locked-box" structures are generally preferred by PE sellers as they offer certainty in the purchase price from the outset (since there is no adjustment), greater control over financial information, potentially reduced contractual liability, cost savings and prompt distribution of sale proceeds to investors/sellers after completion. The buyer will be compensated for any "leakage" of value from the target group following the "locked-box date" save to the extent the parties agree such leakage is to be treated as "permitted".

Other consideration structures commonly used may involve adjustments by reference to working capital and net debt. These structures rely on accounts drawn up shortly after completion with respect to financials at completion and adjustments are then made to the purchase price based on deviations of working capital and net debt at completion from relevant, pre-agreed target figures.

In some instances, there is an escrow account for a short period following completion which is available for payment of any "leakage" or price adjustment claims.

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

A PE seller usually only provides warranties regarding title to its own shares, capacity and authority.

The target's management will often (subject to their percentage ownership and on the basis they are usually better placed to) provide business warranties, under a separate management warranty deed. The key rationale for the warranties is generally to elicit full disclosure regarding the target during the due diligence process, although increasingly (as discussed below) the negotiated warranty package may form the basis for warranty and indemnity insurance protection.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

A PE seller will usually provide pre-completion undertakings in relation to no-leakage (in a locked-box pricing structure) and

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assistance with regulatory filings and, in some cases, undertakings regarding the conduct of the target business pre-completion (although frequently limited to exercise of voting in a manner aimed at achieving such outcome rather than an absolute procure covenant). Indemnities continue to be a rarity, although not unheard of in respect of specific events/circumstances of significant magnitude.

A PE seller is very unlikely to provide non-solicit/non-compete covenants, but these may be provided by members of management who are exiting the target business.

Management will also generally provide pre-completion undertakings regarding the conduct of the target business pre-completion.

6.4 Is warranty and indemnity insurance used to "bridge the gap" where only limited warranties are given by the private equity seller and is it common for this to be offered by private equity sellers as part of the sales process? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such warranty and indemnity insurance policies?

Yes; buyer warranty and indemnity insurance policies are an increasingly common tool for "bridging the gap", and preliminary terms for buy-side insurance are commonly included by PE sellers as part of the initial sell-side transaction documentation, for buyer and insurer to agree during negotiation of the sale and purchase documentation.

These will typically be given on the basis of a set of business warranties given by management, but subject to limitations designed to ensure that the personal liability of management is limited (e.g. recourse may be limited to (i) a seller/management-funded escrow fund or retention account, or (ii) the amount of a proposed transaction bonus payable post-completion by the portfolio company).

Excess and policy limits vary and is somewhat difficult to indicate standards. It is not unusual for the excess to reflect the liability of management (such that the buyer recovers under the insurance only after the liability of management is exceeded). Cap depends on the size of the transaction and the premium payable.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

On the basis that a PE seller's warranties will generally be limited to title, capacity and authority, a PE seller's warranties are usually either subject to a cap equal to the aggregate purchase price, or uncapped.

Liability under any "no-leakage" covenant will generally be uncapped, given that a leakage claim is restitution in nature (the recipient is dropping back in what should not have leaked).

Managers can limit their liability under the warranties by: (i) giving them severally (each manager is only liable for its proportionate share of liability for any claim and/or its own breach) and subject to awareness (as is common); and (ii) capping maximum liability for any warranty claims (it is common for managers to cap at a portion (significant enough to ensure they have skin in the game) of their take-home proceeds).

In a transaction including warranty and indemnity insurance, the cap on management liability for warranties may be set at the level of the insurance deductible.

General limitations include time limits within which claims may be brought, a *de minimis* threshold and, sometimes, culpability.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

Private equity sellers do not generally provide security for any warranties/liabilities – this is generally because (i) they only provide title, capacity and authority warranties (where the risk of claim is generally considered low by buyers) and the relatively short-time period post-completion for any no-leakage/true-up payments (although, in some instances, comfort is given by way of a small escrow for these liabilities), and (ii) they are focused on returning exit proceeds to their investors as soon as possible post-completion and therefore have a negative view of any bids where an escrow or deferred consideration mechanism is proposed.

On the buy-side, save for on secondary buyouts where private equity houses will agree a package with continuing management that typically covers (i) a management warranty deed, and (ii) incentive/equity arrangements moving forward, private equity houses tend to act like any other purchaser in wanting to ensure that there is meaningful recourse for warranties/covenants given by the sell-side.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain if commitments to, or obtained by, an SPV are not complied with (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

The PE sponsor usually gives a direct commitment to the seller that it will (i) call required capital from its investors and that it knows of no reason why such capital would not be paid, or (ii) fund Bidco with the equity capital committed to the transaction, either way is subject only to the satisfaction of the conditions in the share purchase agreement and "certain funds" debt financing being available. The latter for commitment offering greater assurance to a seller and becoming more common in practice. This commitment letter will also include certain commitments from the PE sponsor aimed at ensuring that BidCo draws down the requisite funds under the "certain funds" debt financing in order to complete the transaction.

The seller can generally enforce this commitment directly against the PE fund to the extent it becomes unconditional and the PE fund fails to fund Bidco. If the banks under the "certain funds" debt financing do not fund when they are legally required to, the PE sponsor may be required to take certain steps to enforce against the banks and/or use reasonable endeavours to obtain alternative debt financing. This does not usually extend to the PE sponsor being required to fund such amounts from equity, i.e. there is not typically an equity underwrite of the debt funding.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are relatively unusual in private equity transactions in the UK, and certainly less prevalent than in certain other jurisdictions, including the USA.

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7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

There are a number of key issues which need to be considered by PE sellers considering an IPO exit, including the following:

Market risk – unlike certain other PE exit routes, PE sellers are exposed to market risk when looking to access institutional investor capital through an IPO process. Sellers can look to mitigate this risk by commencing a pre-marketing campaign earlier in the deal timeline to try and secure a successful outcome (equally, however, this means that if there is a need to postpone the transaction for whatever reason, it can be seen as a more significant failure by the investor community).

Lock-ups/selling restrictions – PE sellers may not be able to dispose of their stake in the business completely at the time of the IPO (in fact, in most instances, it will be highly unlikely given the value of portfolio companies generally floated). The PE sellers may be subject to a lock-up period of between six to 12 months during which they would be unable to sell some, or all, of their stake in the business without the consent of the company and its investment bank to prevent detrimental effects on the valuation of the company immediately after the IPO. As such, there would be a delay between the time of the IPO and the time at which the PE fund would fully realise its investment, exposing the PE fund to adverse price movements between the IPO and the final cash realisation. PE sellers may also be subject to a further orderly market period of up to 12 months following the end of the lock-up period. Please see the response to question 7.2 below for further commentary on the duration of lock-ups.

Contractual obligations relating to IPO – the PE seller will be required to be a party to the underwriting agreement entered into with the investment banks underwriting the IPO. The PE seller will be expected to give a suite of representations and warranties to the banks as to a range of matters relating to itself and the shares it owns and, to a more limited extent, the company being floated and its business. It will also be expected to give the underwriting banks a broad transaction indemnity covering any losses they may incur in connection with the transaction.

Corporate governance – on IPO, depending on the listing venue, companies are often required to adopt a particular corporate governance framework. Therefore, whilst the PE seller may have enjoyed contractual rights to board representation and other matters prior to IPO, these are likely to be significantly constrained on completion of the IPO (please see further the response to question 7.3 below). Where a PE seller retains a significant shareholding post-IPO (e.g., more than 30%), the PE seller may also be required to enter into a relationship agreement containing provisions to ensure the independence of the company.

Cost and timing – the costs of an IPO may be significantly higher than a typical sale, primarily as a result of underwriting fees. In addition, an IPO typically requires at least six months from inception to float, as the company's group will need to be prepared for the public market.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

The duration of the lock-up provided by the PE seller will vary from transaction to transaction, but is typically for a period of six months following IPO. As a result, the PE seller will be exposed to market risk for the duration of the lock-up period in respect of any stock it retains, with no ability to sell if the market begins to turn or the company's performance declines.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

In 2016, a number of exits were run as dual-track processes – albeit, most ended up being realised via sales (i) for some of the reasons noted in question 7.1 regarding the ability to realise value immediately and avoid market risk post-IPO, and (ii) with equity capital markets being relatively soft.

In some instances, the IPO track was aborted very later in the process on or about the time of the issuance of "intention to float" announcements. On top of wanting to keep all options opened, sometimes the dual-track continues until late as a means to keep competitive tension among bidders high.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

Traditional bank-led leveraged loan financing remains the most common source of debt finance used to fund both mid-market and large PE transactions in the UK.

However, in recent years, there has been increasing competition between traditional bank lenders and non-bank (or "alternative") lenders for mid-market PE transactions, with funding increasingly being sought from alternative sources such as direct lending funds and other institutional investors. Participants in mid-market transactions have also increasingly looked to implement "unitranche" financing structures, pursuant to which traditional senior and junior debt tranches are replaced by a single tranche term facility carrying a single, blended rate of interest. Other debt instruments, such as PIK ("payment-in-kind") or convertible debt, remains a small portion of the overall financing provided by third-party lenders.

For larger PE transactions, leveraged loans are often structured as a term loan B (or "TLB") – a non-amortising, senior secured term loan. Investors in TLB include a mix of traditional bank lenders and institutional investors.

Aside from leveraged loan financing, high-yield bond financing remains an important source of funds and is commonly used alongside traditional senior secured bank loans.

A key theme in the UK leveraged finance market in recent years – and a function of the increased appetite of institutional investors (who traditionally invested in high-yield bonds) for leveraged loans – has been the convergence of the terms of English law leveraged loans with both high-yield bonds and U.S. leveraged loans. This has led to a general loosening of covenants in English law leveraged loans, with the market becoming more accepting of "covenant-loose" structures (that is, where the relevant loan agreement contains only a single on-going or maintenance financial covenant, usually a leverage ratio) and, for certain stronger borrowers, "covenant-lite" structures (that is, where the loan agreement contains no maintenance financial covenants).

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8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

There are no particular legal requirements or restrictions that would affect the choice or structure of debt financing of PE transactions in the UK generally, although practical deal concerns play an obviously important role in dictating the ultimate financing structure. For example, some PE funds have valued the lighter disclosure requirements of a TLB or leveraged bank loan as compared to a high-yield bond issuance (which requires the preparation of, amongst other things, a detailed offering memorandum). Further, in an acquisition context, another advantage of a loan (rather than a high-yield bond issuance) is that loans can typically be documented and executed on a much shorter timetable that is more aligned with the timing constraints of the acquisition itself. With its successful execution dependent on ever fluctuating market conditions and increased disclosure requirements, a high-yield bond issuance, on the other hand, must typically either be bridged by a loan or funded into an escrow arrangement if being used to finance an acquisition.

Aside from such practical concerns, market participants should be aware of, and ensure compliance with, any industry-specific laws and regulations, as well as the broader regulatory regime affecting private equity transactions.

For example, in the current sensitive political and regulatory climate, market participants need to be especially careful in regards to compliance with anti-bribery, corruption and sanctions laws. Aside from local laws, borrowers and sponsors should also be aware of the expansive nature and potential extraterritorial reach of such laws and regulations in the United States, which can necessitate compliance by many non-U.S. entities (or entities that have only limited U.S. ties).

In the context of public buyout transactions in the UK involving debt finance, a key issue will be to ensure compliance with the "certain funds" and cash confirmation requirements of the Takeover Code. These principles require that a bidder have the funds and resources in place to finance a proposed acquisition, prior to the public announcement of any bid (and the bidder's financial advisor must confirm the availability of such funds). In practical terms, this means that the bidder and its lenders will need to finalise and have executed the required loan documentation (and satisfy, subject to limited exceptions, the conditions precedent to the loan) at the bid stage.

The "certain funds" concept has also increasingly permeated and become a feature of private buyout transactions. Although not a legal requirement in this context, in practical terms, this means that in certain private buyout transactions, lenders will be required to confirm upfront the satisfaction of all of their financing conditions and agree to disapply loan drawstop events (other than certain limited exceptions) until after completion of the acquisition.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

One of the more material tax considerations from an investor's perspective is the reduction or elimination of withholding tax costs on flows of cash back from the portfolio companies to the PE fund, whether in the form of dividends (if any), interest and principal payments or on exit.

Maximising the overall efficiency of cash drawn from investors and external financing providers is generally also a key consideration; deductions for finance costs in respect of shareholder debt in particular can be vulnerable to challenge under thin capitalisation principles or specific anti-erosion measures such as the UK anti-hybrid rules introduced with effect from 1 January 2017 and interest barrier limitations expected to take effect from 1 April 2017, that may restrict interest deductions to 30% of EBITDA.

Management will strongly prefer to plan for low (or no) taxes on acquisition, (including in a secondary transaction by way of rollover reliefs). This is facilitated in practice for structures falling within certain Memoranda of Understanding agreed by the UK tax authorities. Management will often wish to achieve the lowest available rates on exit, being generally 28% for gains derived from carried interest (see question 9.3 below). It is essential to consider planning exit scenarios from the outset.

Off-shore structures are not uncommon above the Bidco level.

9.2 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

As mentioned above, rollover or reorganisation reliefs are available although complex to implement and achieve. As such, rulings may be required. However, it should be noted that valuation rulings are no longer available.

9.3 What are the key tax-efficient arrangements that are typically considered by management teams in private equity portfolio companies (such as growth shares, deferred / vesting arrangements, "entrepreneurs' relief" or "employee shareholder status" in the UK)?

Growth shares and deferred/vesting arrangements remain relevant in the UK. Growth shares are very popular either through low value grants of shares on Day 1 or "joint share ownership plans". "Entrepreneurs' relief" is no longer accessible in respect of carried interest.

The introduction of the "disguised investment management fee" (DIMF) rules and associated legislation in relation to the capital gains tax or income tax treatment of proceeds deriving from carried interest during 2015 and 2016 will mean in practice that the lowest headline tax rate applicable to carried interest is 28%. Higher rates may be relevant (including the various dividend rates and marginal income tax rates) if the carried interest is received in a form that is not capital on general principles (e.g. dividends or interest) or is deemed to be income under the DIMF or income-based carried interest rules.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

The introduction of the diverted profits tax in Finance Act 2015, of the anti-hybrid rules in Finance Act 2016 and the anticipated introduction of the interest barrier rules once Finance Bill 2017 becomes law may result in a decrease in the overall ease of use or efficiency of certain portfolio company structures, including certain OpCo/PropCo arrangements and arrangements reliant on significant interest costs or hybrid instruments or entities to reduce the effective tax rate.

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Anti-avoidance measures preventing certain economic or value allocations (referred to as disguised investment management fees) to investment managers have also been introduced in the form of the DIMF rules. These measures are not intended to cover genuine carried interest allocations or returns on co-investment and are not expected to have an impact on arrangements for external investors.

However, new rules introduced to complement the DIMF rules have also restricted the efficiency of carried interest by limiting non-UK *situs* of the carried interest, removing "base cost shift" planning, and restricting capital gains treatment to fund carry where (broadly) the investment horizon or average is greater than 40 months.

Recently announced changes on recoverability of VAT by investment funds and their managers, and the eligibility of holding companies to register as part of a VAT group may also impact the tax profile of both the target group, of investors and of management in the UK fund management sector.

10 Legal and Regulatory Matters

10.1 What are the key laws and regulations affecting private equity investors and transactions in your jurisdiction, including those that impact private equity transactions differently to other types of transaction?

PE investors and transactions are subject to a broad array of UK statutes applicable in the context of corporate transactions. Key legislation includes the Companies Act 2006, the Financial Services and Markets Act 2000, the Bribery Act 2010, the Takeover Code (in the context of public-to-private transactions), and various taxation statutes. In addition, the Alternative Investment Fund Managers Directive (the "AIFMD") has imposed specific additional regulations on PE investors (see question 10.2 below).

10.2 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

Private equity funds that are managed from or marketed within EU Member States will generally be subject to some, or all, of the rules and regulations promulgated by the AIFMD. In relation to private equity transactions, these rules impose specific disclosure requirements in relation to portfolio companies and restrictions on the ability of private equity fund buyers to release assets from portfolio companies (the so-called "asset-stripping" rules). Clearly this is an area that may be impacted by Brexit, although it is reasonable to predict that pan-European funds may continue to comply regardless.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope etc.)? Do private equity investors engage outside counsel / professionals to conduct all legal / compliance due diligence or is any conducted in-house?

PE sponsors typically conduct relatively detailed legal due diligence – this includes compliance due diligence. Whilst detailed, as the overall scope must be sufficient to satisfy its debt financiers, they tend to be focused on the key issues and subject to sensible materiality thresholds. Legal due diligence is typically conducted by third-party advisers and reliance on such due diligence reports given to the PE sponsor, BidCo and BidCo's debt financiers.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

PE sellers are increasingly concerned with compliance with anti-corruption/bribery legislation principles, particularly given increasing regulatory scrutiny of corporate conduct and potentially significant financial penalties and reputational damage resulting from non-compliance. This trend has been reflected in transaction terms by a general extension of buyers' contractual protection against target groups' non-compliance with laws and regulations.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

Generally, an English court will not "pierce the corporate veil" so as to impose liability on a shareholder for the underlying activities/liabilities of its subsidiary/investee company. However, there are a number of specific instances in which a PE sponsor and its directors, officers or employees may be held liable for its portfolio company's actions or omissions, including: (i) a sponsor could incur liability under EU "parental liability" doctrine, which presumes liability of the sponsor on a joint and several basis with its portfolio company for any breach of EU antitrust law by the latter, where the sponsor has full or decisive influence over the portfolio company's commercial conduct; and (ii) a sponsor could incur Bribery Act liability for failing to implement adequate procedures for its portfolio company.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

While the UK has historically provided an economically attractive venue for private equity investment, the private equity industry, remuneration and returns for its investors and executives are increasingly scrutinised and subject to potentially adverse legislative change. The implementation in practice of changes to the UK tax regime (see also question 9.4 above) are being monitored by PE sponsors and may impact the manner in which deals are structured (particularly in relation to interest deductibility).

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