PRIVATE EQUITY AND VENTURE CAPITAL COMMITTEE // SPRING 2024

PREFERRED RETURNS

Private Equity Investments in India: State of Play

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Despite the decline in investment volume from the peak of 2021 (in line with the global and regional trend of subdued dealmaking), the private equity market in India has shown remarkable growth in the last decade and has gained market share in recent years. Earlier, the PE market in India primarily focused on non-control deals and buyouts had a smaller share of the market. However, there has been a notable shift over the last decade, with the share of control / buyout deals increasing by 4 times in 2023 compared to 2010.

According to the IVCA-EY PE/VC deal trends report for 2023, PE/VC investments continued to decline for the second consecutive year, recording US$49.8 billion in 2023. Growth investments contributed most to the PE/VC investments in 2023 with US$17.1 billion invested across 147 deals. From a sectoral perspective, infrastructure was the leading sector in 2023, followed by real estate, financial services and healthcare. PE/VC exits surged with a remarkable 36% growth to reach US$24.8 billion largely on account of the buoyant capital markets in India. Exits via open market were at an all-time high of US$12.8 billion, mainly comprised of follow-on stake sales in recently listed PE-backed companies. PE-backed IPOs recorded 30 IPOs. There are green shoots of recovery though and PE/VC investments have gotten off to a good start with January 2024 investments significantly higher than both December 2023 and January 2023.

Like any other jurisdiction, cross-border investment in India needs to be undertaken with an understanding of legal and regulatory considerations, jurisdiction specific nuances and commercial deal points. Set out below is a high-level overview of some of the key legal and regulatory considerations for cross-border PE transactions involving unlisted companies in India.

Key regulations governing cross-border private equity investments

Parties to a PE transaction in India have to deal with various regulations in India depending on whether the transaction involves a foreign party, whether the investee is listed in India, the sector in which the investee operates and whether there are anti-trust issues involved.

The principal laws in India governing private equity investments and M&A are the Companies Act, 2013; the Indian Contract Act, 1872; the Foreign Exchange Management Act, 1999 (FEMA); the Income-tax Act, 1961; the Competition Act, 2002; and the Indian Stamp Act, 1899. In the case of listed entities in India, the regulations made by the public markets regulator, being the Securities Exchange Board of India (SEBI), are also applicable for transactions involving listed investee company.

The primary regulators for private equity transactions include the central bank of India, i.e., the Reserve Bank of India (RBI), SEBI, the Ministry of Corporate Affairs (for the Companies Act) and the Competition Commission of India (CCI). Various industries such as banking, insurance, broadcasting, civil aviation and defence have sectoral regulators which may set out certain conditions which apply or require approvals in case of private equity transactions. These could include change in control or acquisition of shareholding beyond specified thresholds, or provisions for transfer of licenses in case of regulated activities.

Structuring of cross border PE transactions

Most private equity transactions are typically structured through the primary or the secondary route, or a combination of both. Some of the key points to be considered for cross border PE transactions are:

• Capital controls: India does not have full capital account convertibility and despite recent relaxations of some of the capital controls (including allowing FDI in most sectors under automatic route), there are various conditions attached to foreign investments, such as sectoral caps for FDI, investment routes (FDI, FPI, FVCI), permitted investment instruments (equity or equity linked instruments), pricing... con't pg. 5

PREFERRED RETURNS

// Spring 2024 EDITION

Message from the Chair

Well it's time to grab your mouse ears and pack your sunscreen, because the ABA's Spring Meeting in Orlando, Florida is about to begin! We are looking forward to seeing many of you in person in sunny Orlando, and for those who are unable to join us in the Sunshine State, we welcome your participation in our various committee and subcommittee meetings virtually. As always, the Private Equity and Venture Capital Committee has lots of great content in store for you!

For those attending in-person, our meetings start with a New Member Breakfast at 9:00 am ET on Thursday, April 4th. Please join us in the Regency Ballroom S on the Convention Level for some breakfast in the half hour leading into our main Committee meeting. It's a great opportunity to catch up with the Committee's leadership and learn about opportunities to get more involved. New and existing members are all welcome.

Following breakfast, our main Committee meeting promises to be packed with great topical content. Lisa Stark will give us an update on the Moelis Decision and lead a discussion on what impacts our members have seen it have on their practice, as well as changes to Delaware law that are in the pipeline; our good friends and Committee sponsors Houlihan Lokey will give us a much anticipated, and rumoured to be more optimistic, market update through the sponsor backed lens; each of our subcommittees will share a little sneak peek at what they have in store and finally, Jonathan Cardenas, Chair of the Emerging Europe Private Equity & Venture Capital Taskforce, will lead a panel discussion on Venture Capital Investment in Ukraine in 2024. He will be joined by Justin Zeefe, Founding Partner, Green Flag Ventures, and Olyana Gordiyenko, Head of Corporate Governance and Compliance, ICU Group.

The great content continues beyond our Committee and Subcommittee rooms with a PEVC Sponsored CLE panel, Private Equity Buyout Funds: International Trends in a Challenging Market. The session, which takes place on Friday, April 5th from 2:00 - 3:30 pm, will be moderated by Jeevanandham Rajagopa (Fox Mandal and Associates LLP), and will feature a panel consisting of Chauncey Lane (Holland & Knight LLP), Till Liebau (Oppenhoff), Caitlin Rose (Fasken Martineau DuMoulin LLP), and Paulo Rocha (Demarest). The session will emphasize the dynamic nature of Private Equity Buyout Funds across jurisdictions, with a focus on strategies employed by the funds to tackle evolving market conditions and industry's broader shift towards sustainable investments. You won't want to miss it.

Beyond the formal meetings and sessions, we're also very much looking forward to catching up with our membership and to the fantastic networking opportunities that abound at the ABA. I hope you have your ticket for our Committee's dinner on Thursday night at The Capital Grille, because it has once again SOLD OUT. It promises to be a great night and I look forward to seeing you there!

A huge thank you to our sponsors, Houlihan Lokey, and Kroll, who helped to make it possible, and again to Houlihan Lokey for being so generous sharing their content. To all of our meeting and panel participants who share their knowledge and expertise with us. To our leadership who work tirelessly to pull it all together. To all those who wrote for the Spring Edition of Preferred Returns for sharing their content with us and to Lawrence Dempsey & Sarah Anischik, the co-editors of Preferred Returns, for all of their efforts turning out another great edition.

I look forward to seeing you soon!

Brett Stewart
Chair

Brett Stewart, McMillan LLP

Generating Liquidity from Illiquid Assets: A Guide to Private Company Tender Offers

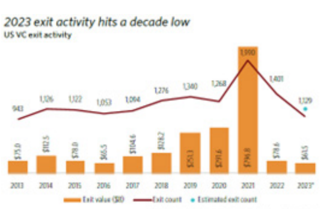
Christopher McKinnon, Partner, Morrison Foerster

Private company tender offers have become increasingly common, especially among late-st

age, highly valued startups. In fact, in the last two quarters (Q4 2023 and Q1 2024), six of the top 10 most highly valued startups in the world have disclosed participation in, or plans to complete, tender offers, including ByteDance, SpaceX, OpenAI, Stripe, Databricks and Canva. As explained by the factors described below, high-value startups have been waiting for IPO and M&A windows to re-open and have been facing growing pressure from longtime employees and early investors to achieve an exit. These late-stage companies have responded by sponsoring tender offers to generate partial liquidity.

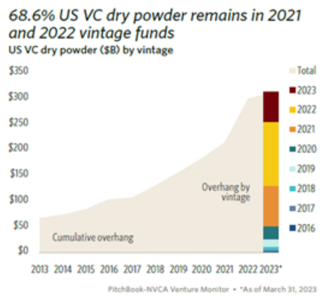
Demand for Liquidity

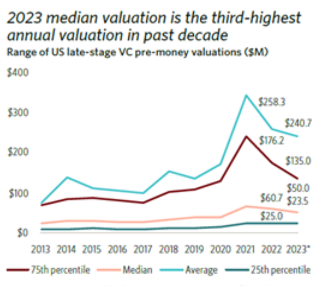
Over the past couple years, there has been a significant slowdown in IPO and M&A exit activity among venture-backed startups. Exits by U.S. venture-backed startups hit a decade low in 2023. Venture capital funds depend on their portfolio companies going public or being sold to generate liquidity to distribute excess capital to their limited partners. Given the slowdown in exit activity, in 2023, distributions to limited partners of U.S. venture capital funds were at their lowest levels in over a decade.



Supply of Capital

Meanwhile, investors are sitting on record-high dry powder (investable capital). However, these investors with ample reserves remain reluctant to deploy capital at, what they perceive to be, elevated valuations. Valuations in investment rounds have started to come down but not fast enough to encourage substantial investment activity across stages and sectors.





Valuation Arbitrage

Fund sponsors can invest in startups at discounted prices by buying shares from existing shareholders in a tender offer, rather than buying shares directly from the company in a new issuance. Unlike in the public company context, where tender offers are generally priced at a premium to the market price, private company tender offers are generally priced at a discount to the price paid in the company's latest fundraising round.

Given the foregoing combination of factors, private company sponsored tender offers are on the rise. In light of this trend, this article summarizes key rules and takeaways to keep in mind when considering a private company tender offer.

What Is a Tender Offer?

A tender offer includes an offer to purchase shares of a company from existing shareholders. SEC rules do not define exactly what constitutes a tender offer. Instead, courts have ruled that a tender offer is an offer that:

1. Involves an active and widespread solicitation of shareholders;

2. Seeks a substantial percentage of the company's shares;

3. Is priced higher than the market price;

4. Includes fixed, rather than negotiable, terms;

5. Is conditioned upon the tender of a fixed number of shares;

6. Is only open for a limited period of time;

7. Pressures shareholders to respond; and

8. Would result in the offeror acquiring a substantial position in the company.

Not all of these factors need to be present in order for a transaction to constitute a tender offer. Courts have adopted a "totality of the circumstances" test in determining whether a transaction involves a tender offer that should be subject to SEC regulation.

Private Company Tender Offer Rules

Tender offer rules are designed to ensure timely, accurate and adequate disclosure so that shareholders can make informed decisions as to whether to tender their shares. If a transaction amounts to a tender offer (regardless of whether the target is public or private), federal securities laws impose a number of requirements, including the following:

- Minimum Offer Period. The offer must remain open for at least 20 business days from commencement. If the terms of the offer change before the offer expires, those changes must be disclosed to eligible sellers and the offer must remain open for at least (i) 10 business days following disclosure of any highly material changes (e.g., to price or quantity of shares sought) or (ii) 5 business days following disclosure of any other material changes.

- Position Statement. The target company must state a position to eligible sellers (recommending they sell or hold), or state no position, regarding the offer within 10 business days of commencement.

- Antifraud Rules. The offeror cannot make material misstatements or omissions in the offer documentation or otherwise undertake fraudulent, deceptive or manipulative acts with respect to the offer.

- MNPI. Persons in possession of material non-public information (MNPI) cannot purchase or sell shares in a tender offer. In practice, this requires that MNPI be disclosed to potential participants (i.e., buyers and sellers), including financial statements, risk factors, capitalization information and other information material to an investment decision.

- Prohibited Transactions. The offeror and certain other parties may not purchase the type of shares sought in the offer while the tender offer remains outstanding, other than through the tender offer at closing, subject to certain exceptions. Sellers cannot tender more shares than they own (i.e., no short or hedged tendering).

- Prompt Payment. The offeror must promptly pay for, or return, the shares tendered (generally within 3 business days per SEC guidance).

While this article focuses principally on tender offer rules applicable to private companies, some of the key differences that apply to public company tender offers are described below.

Public Company Tender Offer Rules

Unlike private company tender offers, public company tender offers must comply with the following additional requirements, among others:

• Tender Offer Statement. The terms of the offer must be set forth in a tender offer statement on Schedule TO and filed with the SEC.

• Best Price Rule. The price paid to everyone must equal the highest price paid to any other shareholder for the same class of shares purchased.

• All-Holders Rule. All holders of shares of the class of shares sought in the offer must be allowed to participate.

• Pro Rata Cutback. If oversubscribed, the amount shareholders can sell must be pared back on a pro rata basis.

• Withdrawal Rights. Tendering shareholders must be permitted to withdraw any previously tendered shares at any time before the offer expires.

By not being subject to the foregoing public company tender offer rules, among others, parties involved in private company tender offers can include creative terms designed to achieve their objectives as to, among other things, price, participation, timing and structure. For example:

• Eligible Sellers. Offerors can make the offer available only to certain classes of shareholders (such as investors, employees or management) or to holders of only certain classes of shares (such as common or preferred stock).

• Fixed Price Per Share Class. Offerors can pay different classes of stock different prices.

• Favored Securities. Offerors can solicit a specific number of shares of different classes of stock or apply cutbacks on a first-come, first-served or a class-by-class basis.

Key Takeaways

Below are key takeaways for parties to consider in evaluating private company tender offers:

• When a third-party investor commences a tender offer to acquire shares of a private company, the target company tends to be significantly involved in order to (i) identify eligible sellers, (ii) manage any transfer restrictions or procedures, (iii) share financial and other information about the company and (iv) update their stock ledger and re-issue stock certificates to reflect the new ownership. Because of this, hostile tender offers, where the company is not supportive of the transaction, are rare in the private company context. Because of that, even though the target company may not be a buyer or seller in a third-party tender offer, private companies can retain influence over the terms, including, among other things, price, eligible sellers, sale amounts, timing, the terms and conditions of the offer and what information about the company is disclosed.

• Private companies may consider launching a self-tender, or facilitating a third-party tender, to acquire shares from existing shareholders as a partial liquidity option to motivate longtime employees and placate early investors who may have expected an earlier exit event. Those companies should determine whether and how that type of liquidity option (structured as a one-off transaction or series of transactions amounting to a sustainable liquidity program) fits into their overall compensation philosophy, financial position and fundraising strategy. A self-tender offer can be done using cash on hand or can be combined with a direct investment in the company by investor(s).

• Tender offer rules can impact even early-stage investors and employees. For example, a tender offer can be implicated in a venture financing round, where a number of existing shareholders (including early investors, founders and employees) are offered the opportunity to cash out some of their equity by selling it to the lead investor in the round as part of a secondary market transaction that may constitute a tender offer.

• If parties desire to mitigate compliance burdens associated with navigating the numerous private company tender offer rules, they can consider structuring a transaction in a way that does not result in a tender offer but nevertheless achieves the parties' commercial objectives.

Private Equity M&A Joint Subcommittee

The Private Equity M&A Joint Subcommittee last met during the M&A Committee's stand alone meeting in Laguna Beach, California on Saturday, January 27, 2024 at 8:45 a.m. pacific time. As we all know by now, there are few better places to be in late January than the Montage in Laguna Beach.

We started our program with what has become an annual tradition – Houlihan Lokey's report on the state of the private equity markets, as well as its forecast for 2024. Youmna Salameh of Houlihan made the presentation. Next up, was Jamillia Ferris of Freshfields, Washington, D.C., who discussed recent Hart Scott Rodino Act developments of interest to private equity M&A lawyers. Next, I briefly discussed what private equity M&A lawyers should understand about the New York Small Business Finance Disclosure Law, and other similar laws across the country. Finally, our Vice Chair Samantha Horn of Stikeman Elliott, Toronto and I had a chance to talk with Bradley Eidsness, in-house at BCI, Victoria, British Columbia, and explore private equity and growth capital transactions, and the business of making them, from Bradley's perspective.

The next meeting of our Joint Subcommittee will be on Friday, April 5, 2024, at 1:30 p.m. eastern time. We will have a pair of panel discussions at the meeting. First, I will be joined on a panel by Vice Chancellor Paul A. Fioravanti, Jr. of the Delaware Court of Chancery, Sara A. Gelsinger of Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Delaware and Joel I. Greenberg of Arnold & Porter LLP, in New York, New York, for a discussion of recent Delaware cases about the enforceability of restrictive covenants and their effect on private equity transactions, Then, Vice Chair Samantha Horn, Andrew Capitman and Ham Crawford of Kroll and Rob Kibbe of Munsch Hardt Kepp & Harr, P.C. of Dallas, Texas will discuss Private Equity M&A from the perspective of the investment bankers, and what Private Equity M&A lawyers can learn from them. We hope all of you can join us in person, and that those who can't meet with us in Orlando are willing to join us online.

My Vice Chair, Samantha Horn of Stikeman Elliott in Toronto, Ontario and I continue to seek YOUR feedback as to the meetings and the Joint Subcommittee. We are always looking for ideas for future programs, presentations and projects, as well as volunteers for all of them. We are also looking to make the meetings themselves more interactive, so please do not hesitate to put your hand up and ask appropriate questions. And, as I've said before, if you haven't met me and you attend the meeting, please feel free to introduce yourself in person or shoot me an email afterwards and introduce yourself. Especially as we continue with hybrid remote/in person meetings, I would love to know who is listening (and have a chance to recruit your participation).

David Albin, Chair

Finn Dixon & Herling LLP

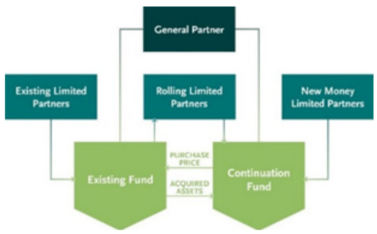
Continuation Funds: A View from North of the Border

Elizabeth Dylke, Partner Benett Jones LLP
Vancouver, BC

Gordon Cameron, Principal, Head of New York Office of
Bennett Jones LLP, New York, New York (Canadian Lawyer)

Private Equity (PE) sponsors, typically led by the general partner (GP) of a PE fund, historically used so-called "Continuation Funds" as a portfolio management tool of last resort when managing under-performing portfolio investments of an otherwise successful fund. Today they are proving to be an exit of choice for investors and sponsors alike. We are now seeing GP-led secondary transactions, in the form of Continuation Funds, used frequently as an attractive solution for liquidity in a market where conventional exits and portfolio company valuations are uncertain. Secondary market volume was USD $115 billion globally in 2023 (42% of which consisted of GP-led transactions) with the secondary market demonstrating significant resilience since 2021 compared to a volume decrease in IPOs, private equity exits and the private M&A market.* As opposed to a mere holding vehicle for distressed assets, Continuation Funds are now utilized as a structuring solution to extract further value from well-performing investments that have yet to reach their full potential and relieve the pressure to sell a stable performing asset in scenarios where fund investors are happy to hold assets for a longer term.

Structure. The PE industry is now familiar with the structure of a Continuation Fund that is used for performing assets, which involves the formation of a new fund by a PE sponsor for the purpose of acquiring one or more performing assets from an original fund managed by that same PE sponsor. Limited Partners (investors) in the original fund are given the option to either roll their existing interests into the Continuation Fund or cash out of the original fund and exit. Interests in the Continuation Fund are then offered to "new money" investors who make cash contributions to the new fund which are used in-turn to cash out the original fund investors that have opted to sell.



Canadian Issues. As Canadian lawyers we are frequently asked to advise U.S. PE funds on Canadian transactions and legal issues related to cross-border transactions, fund formation and fundraising activities. While Continuation Funds are still rare among Canadian PE sponsors compared to U.S. PE sponsors, there are no shortage of Canadian issues that arise given the amount of Canadian capital invested with U.S. and European PE sponsors. Bennett Jones recently acted as Canadian counsel to a U.S.-based private equity fund managing approximately USD $80 billion in assets in connection with two Continuation Fund transactions (one in 2021 and the other in 2023). Each transaction involving the transition of a portfolio of European and U.S. assets valuing ~USD $2 billion. Given the various Canadian institutional investors and capital invested in each of the original funds, the PE sponsor was compelled to consider Canadian regulations at play in using a Continuation Fund structure to retain valued assets. This included Canadian securities offering rules and securities regulations that would be triggered in Canada by Canadian rollover investors and the new Canadian investors participating in the Continuation Fund.

Certain tax efficiencies were realized through the use of Canadian vehicles. To take advantage of certain tax treaties requiring the need for a non-U.S. domiciled special purpose vehicle, the U.S. PE sponsor in these two transactions chose to engage the Province of Ontario as a jurisdiction to form the acquisition vehicle for certain European assets. In scenarios where tax efficiencies are equivalent to traditional tax haven jurisdictions such as the Cayman Islands or Luxembourg, Ontario has proven to be a good choice given its simple registration framework and perception as a "friendly" and "safe" jurisdiction for U.S. connected deals. Ontario limited partnerships can be formed quickly on the basis of a simple filing that discloses only the GP and its address. No summary of partnership terms or list of limited partners is required. The anti-money laundering requirements are not onerous and once the entity is formed, the Canadian regulators tend to leave sponsors alone.

Common Hurdles. The PE industry is also becoming all too familiar with the unique issues presented in Continuation Fund transactions and the growing experience with these types of deals has provided much opportunity for troubleshooting. The inherent nature of Continuation Funds requires the GP to manage inevitable conflicts of interest resulting from the GP being on both sides of the transaction. On one hand, the GP must meet its duty to act in the best interests of existing investors by achieving the best value for the assets being sold by the original fund. On the other, valuation of the transferred assets will have an impact on the GP's carried interest in the new fund. For this reason, achieving a fair valuation is vital to the integrity and reputation of the PE sponsor. If the GP can strike a price that is high enough to provide exiting investors with a sense of good value, but low enough to attract new investment in the continuing assets, then theoretically it can be a win-win situation for all. From a process perspective, Continuation Fund transactions can also be challenging. Managing conflicts and valuation-based approvals often make the negotiations more cumbersome than in a traditional M&A transaction. If the sponsor can run a streamlined and transparent process, it may be that in a period of market uncertainty, GP-Led Continuation Funds will become a preferred method of exit for investors.

Managing Hurdles. The more common use of Continuation Funds has allowed the industry to develop tools which can be employed to ensure a smooth transaction. In May of 2023, The Institutional Limited Partners Association (ILPA) released guidance on Continuation Fund best practices, which included recommendations of full transparency and a strong role for LP Advisory Committees to oversee conflicts and valuations. From a practical perspective, setting realistic and achievable timelines will give the transaction credibility and mitigate a possible tendency for investors to get frustrated or have second thoughts in a drawn-out valuation, funding and closing process. A measured approach that involves engaging investors as early as possible and well before the election date required to opt into the new fund while providing them ample disclosure of information will give investors a sense of confidence in the deal. It should also relieve investors from the pressure that inevitably comes from having to make quick decisions on whether to stay or go. In addition, with respect to deal terms of the new fund, GPs are expected to also participate and keep their money invested in the new fund as the more "skin" the GP has in the game, the more likely there is to be a sense among rollover and new money investors that their risk-reward rationale for the transaction is aligned with that of the sponsor's.

Looking Forward. From North of the border we are looking forward to the various ways in which Canadian players will continue to participate and shape the secondary market. We expect the volume of successful GP-led transactions to continue to provide liquidity solutions for investors and opportunities for PE sponsors to nurture value in mature assets.

* Source: PJT Partners FY 2023 Secondary Market Insight Investor Roadmap

Things to do in Orlando!

Activities:

Drive-Thru Safari Park at Wild Florida: Drive your own car through a safari park on a self-guided tour.

Manatee Encounter: See some amazing wildlife on a beginner-friendly 3-hour paddle by Kayak in Orlando. Have your cameras ready for the manatee encounter, sun bathing gators, and basking turtles. https://www.getyourguide.com

Titanic Artifact Exhibition: Revisit the Titanic, the ill-fated ocean liner, at a stunning Orlando exhibition that features numerous galleries and interactive exhibits.

The Wheel at ICON Park Observation Wheel: Observe Orlando's most famous landmarks from a height of 400 feet during one full rotation around The Wheel at ICON Park. Enjoy exceptional views of Cape Canaveral, downtown Orlando, and Floridian landscape from an air-conditioned capsule.

Restaurants:

The Stubborn Mule: New American featuring salads, sandwiches, flatbreads and entrees. Their bar menu focuses on moscow mule cocktails, craft beer and wine.

Debonair Supper Club: New restaurant in the heart of downtown Orlando serving elevated contemporary comfort cuisine and cocktails.

High T: Unique and eclectic bar and speakeasy themed after Alice in Wonderland

Schedule of Events

> Business Law Section's Spring Meeting | April, 2024

Links to Meetings for virtual attendees will be located on the ABA Business Law Section's Virtual Meeting Website.

Thursday, April 4, 2024		
New Member Breakfast - Please join us!	Regency Ballroom S, Convention Level	9:00 AM - 9:30 AM
Private Equity and Venture Capital Committee Meeting	Regency Ballroom S, Convention Level	9:30 AM - 11:30 AM
Financial Services Technology Joint Subcommittee Meeting	Regency Ballroom P, Convention Level	1:30 PM - 2:30 PM
Angel Venture Capital Subcommittee Meeting	Regency Ballroom P, Convention Level	2:30 PM - 3:30 PM
PEVC Jurisprudence Subcommittee Meeting	Regency Ballroom P, Convention Level	3:30 PM - 4:30 PM
Private Equity & Venture Capital Committee Dinner	The Capital Grille	7:30 PM - 9:30 PM Tickets Sold Out!
Friday, April 5, 2024		
International VC & PE Subcommittee Meeting	Regency Ballroom O, Convention Level	9:00 AM - 10:00 AM
Private Equity and Venture Capital Leadership Meeting	Regency Ballroom O, Convention Level	10:00 AM - 11:00 AM *Closed Meeting
PEVC Funds Subcommittee Meeting	Regency Ballroom O, Conven-tion Level	11:00 AM - 12:00 PM
Private Equity M&A Joint Subcommittee Meeting	Regency Ballroom S, Convention Level	1:30 PM - 2:45 PM
CLE Program: Private Equity Buyout Funds: International Trends in a Chal-lenging Market	Regency Ballroom V, Convention Level	2:00 PM - 3:30 PM

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Committee Social Media Pages

www.linkedin.com/groups/2395267

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We are Sponsoring a Great CLE Program!

Private Equity Buyout Funds: International Trends in a Challenging Market

Friday April 5, 2024 - 2:00 PM to 3:30 PM
Location: Regency Ballroom V, Convention Level
Private Equity Buyout Funds, in acquiring controlling stakes in companies, navigate market challenges adeptly by employing innovative strategies to identify and seize lucrative opportunities. This program emphasizes the dynamic nature of Private Equity Buyout Funds across jurisdictions, with a focus on strategies employed by them to tackle evolving market conditions and industry's broader shift towards sustainable investments.
Presented By: Private Equity and Venture Capital
Co-sponsoring Committee(s): International Business Law, International Coordinating

And We're Co-Sponsoring five more!

Beneficial Ownership Reporting: The Influence of the Corporate Transparency Act
Thursday | 2:00 PM to 3:00 PM | Celebration 3-4, Convention Level
Presented By: Banking Law

Corporate Director and Officer Liability: The Basics and Hot Topics
Friday | 8:00 AM to 9:30 AM | Location: Regency Ballroom T, Convention Level

Ethics in the Boardroom: How In-House and Outside Counsel Can Support and Protect Directors
Friday | 10:00 AM to 11:30 AM | Location: Regency Ballroom V, Convention Level
Presented By: Corporate Governance

Legal Opinions: What Those in the Know Don't Cover
Friday | 2:00 PM to 3:30 PM |Location: Regency Ballroom T, Convention Level
Presented By: Legal Opinions

Gender-Inclusive Drafting in Transactional and Litigation Documents
Friday | 4:00 PM to 5:00 PM | Location: Celebration 1-2, Convention Level
Presented By: Diversity, Equity, and Inclusion

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Comedy and Law: The Price of Dying

Son Tran, Senior Legal Counsel – Trading/Gas & Power, Shell USA, Inc. Houston, Texas

There was no doubt about it. I was dying. In fact, I had been dying for the last 15 minutes but the pain of it was becoming very acute. Even though I was the youngest person in the room, I was the one sweating and breathing heavily. It was my own fault for accepting an offer to perform comedy for a group of senior women in a small town in Texas on that hot summer day. Like too many stand-up comics before me, I had severely overestimated my skill.

My venture into the world of stand-up comedy began in 2014. At the time I was a young-ish father to a seven-year-old boy and a four-year-old girl. We lived in a nice suburb outside of Houston and I had a stable job working for an energy company. I had grown my legal career beginning in Calgary eventually moving to California, New York and Houston, seeing the country through my work. I had carved out a place for myself developing my expertise in the energy law field and was managing a team of attorneys and contract professionals.

My wife was enjoying herself as a stay-at-home mother and the kids were flourishing. Yet something was missing. I had the feeling that there was something that I was supposed to be doing and neglecting. I slowly began to realize that I was neglecting myself.

My days were dedicated to my employer, making sure the company was protected, looking out for the people on my team and providing answers to colleagues who had questions. My nights and weekends were consumed by the health and well-being of my children and my wife and the daily upkeep of the material things that surrounded us. It was not a bad life by any stretch, but it felt … incomplete.

From an early age I had a strong creative drive, especially when it came to the written word. I ran through books at a rate that would have bankrupted my parents had it not been for the public library system. I began to write my own stories and joined theater in high school.

But as people say "real life" began to impose itself on me and I had to focus myself on getting through law school. In the early stages of my career, I worked late, as many of us do, proving my worth to the firm. My creative endeavours took a back seat and then eventually faded away, like toy placed in a box.

In New York I found myself at the Comedy Cellar one night. At the time I was working for an investment bank that would become infamous. My wife and I were enjoying the lifestyle and energy of a young, childless couple in the "Big City".

At the comedy show that night we saw several famous comedians including Gary Gulman and Dave Attell. If this were a Hollywood movie one of those comedians would have whispered some inspiring words to me and I would have started performing the next day. But this was real life and I walked away from that show with nothing more than a grainy photo with Gary Gulman.

As my career settled down my personal life was just ramping up. Any spare time I thought I might have was gone after my wife and I had our first child. I could not have been happier to be a father and threw myself into the role, rushing home from work to see my son only to be told I could not pick him up because he was finally sleeping. I had to placate myself with staring at him, using whatever Jedi mind tricks I could to will the baby to wake up.

My daughter came along a few years later and now I had two friends to play with. Yet even in those days when the children were finally asleep, the clothes had been washed and folded and the kitchen cleaned I had that feeling something still needed to be done.

As my children grew older and needed less constant attention, I began to stretch those creative muscles a little more. Almost like someone who picks up that forgotten baseball glove and has a game of catch after years away. I began by writing movie reviews for a small website. I doubt if more than 100 people read my reviews. Then I began to write articles for a comedy website. At its height those pieces I wrote were being viewed by millions of people. It was at that point I realized I was having as much fun reading the comments people left on my article as I had writing them. It was the feedback that I really enjoyed. Prior to that I felt like I was writing into a vacuum.

It was then that I remembered that night at the Comedy Cellar. Although I was in the audience I recalled thinking how amazing it would be to be on that stage making people laugh. The people I had watched that night seemed to be doing something that was completely out of reach. But with my writing experience I thought perhaps it was something I could do that would incorporate my love of performing and writing.

My first night performing stand-up comedy was six months away still though because I was a trained attorney. This meant there was research and preparation I needed to complete. I began to Google highly technical topics like "How do you do stand-up comedy?" and "How do you write jokes?". I debated writing a memo on the topic but ultimately decided against it.

I started watching comedy specials and documentaries about stand-up comedy and began to seriously wonder if comedy really involved that much drinking and drug use. (The answer is yes, but not by me). Then I started writing jokes. Page of jokes. Pages of horrible, terrible jokes that no one would ever find funny. Finally, it was time to Google, "Open Mics in Houston." I stepped on the stage for the first time shortly after that and I have never looked back.

It's been almost 10 years since I first told jokes to a room full of strangers and I enjoy it as much today as I did back then. I had very modest goals when I began, never expecting to do much more than open mics and perhaps get paid to do a real comedy show.

But over the years I've managed to perform all over the world including Europe and Asia. I have worked with amazing headliners in front of crowds of hundreds of people. I even had the chance to perform for the troops in Afghanistan where we did nine shows in ten days. I should clarify it was the American troops, it wasn't some weird Taliban comedy tour. I've won contests (and lost many more than I've won) and have been accepted into dozens of festivals. I've also made a little bit of money.

But despite all those things what I still enjoy the most is when I am on stage and the show is going really well. On those nights I let myself just enjoy the laughter, getting lost in that moment. There is nothing like a group of strangers letting you know that you've brought them happiness and laughter. This is why I still perform 10 years later.

As a whole, lawyers are a motivated group of professionals. We strive to always find the right answer and the best solution. But sometimes that drive can lead us to forget to take time for ourselves. We can be good lawyers and fathers and mothers, but we should also remember to be good to ourselves. It's OK to be a little selfish and indulge in your passions. Some of the best attorneys I know are the ones that have shared their love of photography, music or woodworking with me. I believe that bringing your whole self to whatever you do will help you in all areas of your life.

Now I share my whole self with my children. They know me as a father, a husband, a lawyer and, yes, a comedian. My daughter has taken to stalking me on social media and always lets me know when I do something that isn't funny. And even when I have moments, like that show in front of those senior citizens, I understand that sometimes the price of dying, is to live a little.

How To Navigate "EU Competition Law Transactional Risks"? A Few Points of Attention for Investment Funds with Respect to the Belgian FDI Screening Regime

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Dealing with European competition law transactional risks in acquisitions by US funds has recently become more complex. First, the instruments to control transactions have been multiplied by three. Besides the traditional merger control regime, a foreign subsidies (FSR) control system at the EU level and a foreign direct investment (FDI) screening regime at the Member State level have been developed. Secondly, there are multiple combinations of parallel procedures such as one EU or several national merger control procedures (with the possibility for the parties to refer the transaction to the EU Commission), one EU FSR procedure and/or several national FDI screening procedures (with no possibility for the parties to refer the transaction to the EU Commission). Thirdly, the scope of the traditional merger control regime has been widened in cases where there is no notification obligation. On the one hand, as could be seen in the Illumina/Grail case, Member States can refer a transaction to the EU Commission while the parties were not under any obligation to notify this transaction at the EU or Member State level. On the other hand, as could also be seen in the Towercast and Proximus/EDPNet cases, third parties can request before a national court or a national competition authority to prohibit a transaction because it would lead to an abuse of dominant position in case the acquirer already holds a dominant position on the market where the target is active.

In this article, we will give a few points of attention for investment funds with respect the FDI screening regime of Belgium, which requires a notification (and the corresponding application of a "standstill" obligation) in case of a direct investment in a company established in Belgium or in an undertaking carrying out an economic activity in Belgium by a foreign investor which "may affect security or public order in Belgium or the strategic interests of the (Belgian) federated entities".

Under the Belgian FDI screening regime, besides the acquisition of control over an undertaking exercising an economic activity in Belgium (which can simply encompass assets generating a turnover from Belgium), minority acquisitions of at least 10% or 25% of the voting rights of a target company established in Belgium are qualified as a "direct investment" and, therefore, fall within its scope of application.

A first consequence is that internal restructuring can also fall within the scope of the Belgian FDI screening regime. For example, a foreign (US) investor (i) already "controls" a company established in Belgium through a French subsidiary holding 100% of its shares and (ii) decides that the French subsidiary should sell 30% of such Belgian company to its Irish subsidiary. Such a transaction is not only an internal restructuring but it is also an acquisition of 25% of the voting rights of a company established in Belgium falling within the scope of the Belgian FDI screening regime (which needs to be notified if it has a potential effect on security or public order in Belgium or on the strategic interests of the Belgian federated entities). A second consequence is that there is not complete alignment with the traditional concept of control, in which it is the investment company which usually controls the different funds it sets up, and investors typically participate as limited partners and normally do not exercise control, either individually or collectively, over the portfolio companies in which the funds invest. Therefore, to qualify as a "foreign investor," the place of the primary residence of both the investor (which can qualify as the ultimate beneficiary owner) and the management company making the direct investment can be relevant.

A third consequence of the application of two different thresholds of voting rights is that under the threshold of 10% of voting rights, an additional "turnover" threshold is applicable (i.e., the target acquired needs to generate a turnover of EUR 100 million), while under the threshold of 25% of voting rights, no "turnover" threshold is applicable (see, however, the exception below for the biotechnology sector). The Belgian FDI screening regime is based on the list of sectors set out under Article 4(1) of EU Regulation 2019/452 establishing a framework for the screening of foreign direct investments into the Union in order to determine if a foreign direct investment "may affect security or public order in Belgium or the strategic interests of the (Belgian) federated entities". However, the long list of sectors covered by the Belgian FDI screening regime is slightly different from the list of the set out under Article 4(1) of EU regulation 2019/452. On the one hand, the initial EU list has been widened by adding the "private security" sector. On the other hand, the initial EU list has been narrowed. First, this list is only relevant for acquisitions of at least 25% of a target company established in Belgium. For acquisitions of at least 10% of voting rights, only a list of "unspecified" traditional sectors such as defense, energy (including dual use products), communications and cybersecurity, is applicable. Second, the condition that the activity of the target must concern "technologies and raw materials which are essential" has been added to the list of sectors of "critical technologies and dual use items" set out under Article 4(1)(b) of EU Regulation 2019/452, i.e.: "artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies." In other words, in the case of an acquisition of at least 25% of voting rights of a Belgian target company, it is not sufficient that the activity of the target concerns critical technologies such as artificial intelligence or robotics, it must also concern "technologies and raw materials which are essential" for such critical technologies. Third, a turnover threshold of EUR 25 million has been exceptionally added for the acquisition of at least 25% of voting rights of a Belgian target company active in the biotechnology sector.

It is important to note that, in Belgium, the sector of software does not directly fall within the scope of the FDI screening regime. However, if a Belgian target is selling a software which is used, for example, to optimize the process of critical infrastructures (such as high voltage grids, health care institutions or drinking water distribution networks) or the functioning of critical technologies, the investment made by a fund in such a target may have to be notified under the Belgian FDI screening regime.

Con’t from cover...

(fair market value being the floor or cap, as applicable), modes of payment of consideration (deferred consideration, holdbacks or non-cash consideration), downstream investments and FDI screening. Moreover, exit rights providing assured returns or downside protections are not permitted. Deviation from conditions laid down under the exchange control laws require the prior approval of the RBI or the Government of India, as applicable. Therefore, the nature of investment instruments, consideration mechanism and its discharge, earn-outs, deferred consideration and pricing of exits are structured with due consideration to such capital controls.

- **Regulatory / Anti-trust approvals:** The transaction could require different regulatory approvals, consents and licenses depending on the industry / sector of the target, the shareholding percentage involved and the structure of the transaction. For Indian listed companies, any acquisition of shareholding beyond prescribed thresholds or acquisition of control, would trigger the requirement to make a mandatory tender offer under the takeover regulations. Parties should bear in mind the potential anti-trust related issues and consequential filings to be made with the CCI if certain prescribed thresholds or conditions are met. The feasibility and timelines of getting these approvals is an important consideration for the transactions.
- **Tax considerations:** As is the case with most jurisdictions, the extant taxation policies have a significant bearing on structuring and negotiation of private equity transactions in India as well. The tax treaties signed by the Indian government and the ensuing tax benefits (such as taxation of capital gains and dividends) may affect the decision of the PE investor with respect to the choice of jurisdiction of the investing entity as well as the investment instrument.

Key aspects of deal documentation

With the maturity and remarkable growth in the PE market in India in the last decade or so, the key provisions of deal documentation for PE investments have gradually evolved and largely mirror the UK or US market practice, subject to adaptation for Indian law. Transaction documents are usually investor friendly, except in situations of seller-led auction sales or where PE / institutional investors are the sellers.

Depending on the nature of PE investment (growth, minority or control), certain key contractual terms that have become well recognised and accepted as market practice include, extensive warranties with loss-based indemnities, conditions precedent, pre-closing covenants (including standstill and exclusivity/no shop), payment structures and mechanism (locked-box, post-closing adjustment, holdbacks, escrow, deferred consideration), termination, information and audit rights, governance / management rights, affirmative/veto rights on identified matters, transfer restrictions on shares (lock-in, claw-back, ROFO/ROFR, tag-along/co-sale), anti-dilution protection, pre-emptive rights, liquidation protection, exit rights, events of default, non-compete restrictions and dispute resolutions.

The typical exit modes preferred by PE investors include IPOs, private sales, strategic sales, drag along rights and buy-back/ put options. PE investors prefer to retain their flexibility in exercising any of the exit modes without any fetters.

Impact funds and the ESG aligned PE investors are now seeking inclusion of extensive ESG-specific warranties, adoption of ESG action plans, tailor-made sector-specific covenants related to ESG risk factors and robust default provisions (including accelerated exit and material breach) in case of breach of ESG commitments by the investee company in deal documents. This allows the investor to exit from companies that are not aligned on ESG principles.

As a matter of practice, most of the terms of shareholders’ agreement pertaining to governance, voting rights, information, share ownership and transfer restrictions, privileges, voting and various protective provisions are incorporated into the charter document / articles of association of the company for the purposes of enforceability.

Warranties and indemnity

Typically, private equity and M&A transactions in India incorporate comprehensive and detailed warranties with recourse to indemnity for breaches. It is fairly common to incorporate sandbagging provisions and for bring-down of warranties at closing. Warranties, qualifiers (materiality, knowledge and monetary) and indemnities are heavily negotiated in India. It is not uncommon to see detailed limitations on liability being negotiated and incorporated in the transaction documents. Some of the standard limitations include monetary caps (de-minimis, basket and aggregate thresholds) and time limits / survival periods (varies for fundamental, business and tax warranties), no double recovery and mitigation. Fraud is carved out from limitations on liability.

PE or institutional investors (with a minority position) provide only a limited set of warranties around capacity, authority, title to shares and share transfer taxes, in relation to sale of their stakes. However, in situations where the PE investor has a majority position / control in the investee company, PE investors agree to provide limited business warranties. In cases of share transfers involving a foreign seller, extensive warranties for share transfer taxes with tax indemnities for such transfer taxes are also negotiated. In such situations (particularly for high value deals), buy-side W&I insurance and tax insurance is preferred. W&I insurance obtained for India deals have APAC style coverage (and not US style coverage) where known issues are excluded.

Conditionality and deal certainty

While it is an acceptable practice to incorporate closing conditions in a PE transaction, sellers and investee companies always push back against non-critical issues being included as a condition precedent. Regulatory approvals, lender and third-party consents, MAC (material adverse change) and key due diligence issues that need resolution prior to closing are incorporated as conditions precedent. MAC clauses are being increasingly used in PE transactions in the last decade, more so in transactions involving a substantial time gap between signing and closing. However, the MAC triggers (monetary thresholds and materiality) as well as carve-outs to MAC are extensively discussed and negotiated.

Break-fees or reverse break-fees as deal protection measures are not very common in India. However, their use is steadily increasing in the bigger and more complex M&A deals or in auction sales. Such fees are a matter of contractual negotiation between the parties and there are no specific regulations dealing with such fees (including quantum or trigger). Moreover, inclusion and/or payment of such fees as a deal protection measure have not been tested before a regulator or court of law.

Anti-trust related trends in PE transactions

- The CCI is currently conducting a market study into the competition issues in the PE sector to better understand and address the potential anti-competitive outcomes.

- Common shareholding and interest: **T**he CCI is increasingly scrutinizing common ownership of PE investors in competing enterprises. The concern stems from the potentially diminished incentive to effectively compete even in the absence of a controlling stake in competitors. In a recent case, where the PE investor was increasing its shareholding and continuing to be a minority shareholder with affirmative voting rights and board representation rights on the target group, the CCI considered the acquirer’s indirect overlap (through a related fund) with the target enterprise to raise anti-competitive issues. The CCI’s concern was that the common interest and, direct or indirect, influence, if any, of the acquirer group in the two competing companies, may raise the risk of softening of competition between the two prominent players. The acquirer offered voluntary commitments to not participate in or influence the affairs of the overlapping business of the target to alleviate the potential competition concerns to receive an approval with modifications.

- Common directorship: Common directors in portfolio companies and concerns regarding information sharing and reduction in competition have also been scrutinized by the CCI. In a transaction involving a PE investor’s increase in minority shareholding along with a seat on the board of directors of the target, the CCI was concerned with the acquirer’s shareholding and board representation in competing pharmaceutical companies. The acquirer offered voluntary commitments to remove the nominee director from the board of the competing company to address the competition concern and received an approval.

PE investments in India remain significant, which reflect the sustained interest and confidence of investors in the promising economic conditions and growth potential of India. Given the complex and ever-evolving regulatory environment, foreign PE investors should consider seeking expert counsel when exploring investment opportunities in India.

External sources:
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NEXT MEETING

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ARTICLES & AUTHORS NEEDED

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Articles should be 1500 words or less, and on any topic of interest to practitioners in the private equity and venture capital sectors. From short scholarly articles, to practice tips, reviews/summaries of a Section program, life in the trenches, interesting pro bono projects, humorous looks at life and the law, or even how you balance work and personal life. We appreciate your help in making this newsletter a success.

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