



# Private Equity

Fund formation and transactions  
in 42 jurisdictions worldwide

# 2009

Contributing editor: Casey Cogut



Published by  
**GETTING THE DEAL THROUGH**  
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Published by  
Law Business Research Ltd  
87 Lancaster Road  
London, W11 1QQ, UK  
Tel: +44 20 7908 1188  
Fax: +44 20 7229 6910  
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ISSN 1746-5524

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Printed and distributed by  
Encompass Print Solutions.  
Tel: 0870 897 3239

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# Ireland

Andrew Lawless and Sean Murray

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## 1 Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction?

Private equity transactions fall into three broad categories:

- start-ups: this is the funding of a business starting from scratch;
- development capital: this is funding for an already existing business to help it expand; and
- buyouts: this is the funding of purchases of businesses by management teams. They include management buyouts (MBOs), management buyins (MBIs), institutional buyouts (IBOs) and public-to-private transactions.

## 2 Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or become public companies?

There have been no recent corporate governance reforms specific to private equity transactions; however, there has generally been an increased awareness among private companies of the need to maintain general corporate compliance, arising from proposed legislative amendments to provide for the imposition of increased liabilities and sanctions upon the 'management' of private companies.

The main advantages of going private in leveraged buyout transactions arise from the departure from the Irish Stock Exchange Listing Rules (the Listing Rules), which enables more flexible corporate governance and provides the opportunity to enter into more negotiable security and financing packages.

## 3 Issues facing public company boards

What are the issues facing boards of directors of public companies considering entering into a going-private or private equity transaction? What is the role of a special committee in such a transaction where management members of the board are participating in the transaction?

Public-to-private transactions are governed by the Companies Acts 1963–2006, the Irish Stock Exchange (ISE) and the Irish Takeover Panel Act 1997 (the Act), the Takeover Rules 2001 and 2002, Takeover (Amendment) Rules 2006 and Irish Takeover Panel Act 1997, Takeover (Certain Relevant Companies) Rules 2006 (the Takeover Rules).

The Takeover Rules provide the principal regulatory framework for conducting takeovers and are issued and administered under the Act by the Takeover Panel. The Takeover Rules are based on a number of general principles contained in the Act.

The directors of public companies will consider the form of

investment and whether it will consist of debt, equity, or both, and the effect that such funding will have upon the terms of employment on management, the potential level of management control over the company by the investor, the form of protection to be provided to safeguard the debt provider's investment and any potential incentives that may be available such as shares, options and ratchets, to encourage company management to produce healthy income returns and to facilitate a successful exit from a private equity transaction.

Where members of the target company's management are to participate in a going-private transaction, notification to the board of their potential conflict is required. Accordingly, an independent committee of the target board is formed comprising non-executive and non-participating directors who are independent of the management directors (the MBO team) who are participating in the transaction. The MBO team is required to cooperate with the committee of the target and their advisers in identifying and providing requested information. Such information includes but is not limited to all business plans, models and other financial information to third-party debt or equity providers. The committee has primary responsibility for considering the merits of the offer and advising target shareholders of its views in respect of the offer and will usually negotiate the terms of the offer with the MBO team.

## 4 Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

The Companies Acts 1963–2006 (including the Irish Regulations implementing the Market Abuse Directive and the Transparency Directive), the Takeover Rules, the Substantial Acquisition Rules 2001 (SARS) and the Listing Rules contain provisions with regard to disclosure obligations, including disclosure triggers.

The Takeover Rules require extensive public disclosure of the terms of a going-private transaction, including details of financial and other arrangements with management, information on the bidder and the sources of finance that are funding the transaction. Extensive public disclosure of management's (and other parties including any person presuming to be acting in concert with the bidder) existing interests and dealings in target and bidder securities will be required.

Pursuant to the Companies Acts, directors, shadow directors and their families are obliged to disclose their interests in shares or debentures in all Irish registered companies.

There are no heightened disclosure issues on other private equity transactions.

## 5 Timing considerations

What are the timing considerations for a going-private or other private equity transaction?

In respect of a going-private transaction, it is important to note that strict time limits are set out in the Takeover Rules in respect of certain milestones relating to an offer for shares in a public company. The offer bid starts with the announcement of a firm intention to make a bid. An offer document must be sent to the target's shareholders within 28 days of the announcement of this firm intention to make an offer. The offer must initially remain open for acceptance for 21 days following the day the offer document is posted. If a hostile bid has been made, the target has 14 days from the date the offer document is posted to issue its defence document advising its shareholders on the merits and disadvantages of the offer. A bid must be conditional on the offeror acquiring shares carrying more than 50 per cent of the target's voting rights. The offeror has up to 60 days from posting the offer document to satisfy this condition unless the timetable is extended by the Takeover Panel. In practice, the offer is usually made conditional on a certain number of acceptances in excess of 50 per cent being obtained. If the required level of acceptance is received within the first 21 days of the offer period, the offer must remain open for a further 14 days.

When the acceptance condition has been satisfied, the offeror has a further 21 days to satisfy the other conditions of the offer. This gives a maximum period of 81 days to satisfy conditions, assuming that the acceptance condition is not satisfied before the 60th day. The offeror must send the consideration due to the target shareholders who have accepted the offer within 14 days of offer being declared wholly unconditional. The terms of the offer can be improved by the offeror, provided that it is not restricted in its ability to do so in the initial offer document. An offeror can revise the terms of its offer up until the 46th day after posting the offer document.

Typical main timing considerations for other private equity transactions relate to notice for shareholder approval requirements whereby the timing of the notice period will vary depending on whether an ordinary or special resolution is required.

## 6 Purchase agreements

What purchase agreement issues are specific to private equity transactions?

Generally, the representations and warranties in respect of a private equity transaction are similar to that of a merger or acquisition and the issues specific to private equity transactions are significantly influenced by the debt finance structure financing the investment.

In a buyout, the level of warranty cover offered to the purchaser by the vendor will usually be significantly lower than a purchase between arm's-length parties because of the knowledge that management has about the target company. However, such a reduced level of warranty protection, though acceptable to management, could prove unacceptable to the private equity fund provider funding the transaction.

In a going-private transaction the shares acquired through a public takeover offer will not have the benefit of any warranties or indemnities and the target itself will not give any warranties.

## 7 Participation of target company's management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues?

Management may take a stake in the bidder, an option which is not normally available to other shareholders. In such going-private transactions, the Takeover Panel has to be consulted in advance and

its consent obtained to any special deals with management. In some instances, shareholder approval may also be required.

As the capital gains tax rate is lower than the income tax rate, the executive compensation schemes are influenced by tax-efficiency issues. Examples of such schemes include equity ratchets and employee share option schemes.

## 8 Tax issues

What are the basic tax issues involved in private equity transactions? Can share acquisitions be classified as asset acquisitions for tax purposes?

The key issues involved in private equity transactions are:

- to minimise the tax cost of the transaction itself;
- to maximise deductibility of interest on debt financing (including shareholder debt, mezzanine or subordinated debt and senior debt);
- to avoid Irish withholding tax on the interest payments (eg, use of EU or double tax treaty lenders, Eurobond exemption, wholesale debt exemption, etc); and
- to implement a structure minimising the ongoing tax burden while permitting a tax-optimised exit. As with most tax systems, the Irish tax regime is complicated, so specific advice needs to be taken in each case.

Under the Irish tax regime, a share deal cannot be treated as an asset deal for tax purposes (ie, there is no equivalent to a US section 338(h)(10) election).

As regards the management team, one key issue is to avoid any increase in value of the equity incentives being treated as income for tax purposes and to take advantage of the capital gains tax regime insofar as possible for individual investors (which includes both the management teams and also individuals within the investing institutions).

## 9 Existing indebtedness

What issues are raised by existing indebtedness at a potential target of a private equity transaction? How are these issues resolved?

The principal issues raised by existing indebtedness at target level relate to price, repayment mechanics and release of existing security.

Existing debt will influence the valuation of the purchase price for the business.

It is necessary for the mechanics of repayment to be agreed at closing and in most cases this will result in the repayment of the target's outstanding debts directly to the lenders and the security will be released upon receipt of full payment of the relevant debt. Such existing indebtedness is discharged and replaced by the new indebtedness received from the new lenders and a new indebtedness arising from the provision of new security becomes effective by virtue of the security documents and upon the release of the existing security.

In accordance with section 60 of the Companies Act 1963, it is unlawful for a target company in a buyout to give security to lenders, unless the 'whitewash procedure' is successfully implemented.

## 10 Debt financing structures

What types of debt are used to finance going-private or private equity transactions? Do margin loan restrictions affect the debt financing structure of these transactions?

Debt financing techniques used include:

- senior debt: this is a secured credit facility;
- junior debt: an unsecured or junior-secured credit facility;

- mezzanine finance: an additional layer of finance that carries a higher rate of interest than senior debt and ranks behind the acquisition debt security. Mezzanine finance will also be granted warrants;
- high-yield bonds: often this is put in place after completion on larger buyouts, to replace bank debt with cheaper financing and usually replaces mezzanine finance; and
- loan notes: these are a form of transferable loan, which will usually be secured by way of a charge over the assets of the bidder supported by guarantee and a further charge over the assets of the target.

The debt finance is usually comprised of a combination of senior debt facilities (70 per cent), high yield bonds (0-5 per cent), and mezzanine loans (25-30 per cent), and any shareholder loans in a deal would typically be considered as part of the equity stack. Bank funding typically takes the form of senior secured facilities and, depending on the deal, may include one or more elements of subordinated debt such as mezzanine or junior facilities. The subordinated debt usually includes some element of shareholder or promoter participation, although this is often structured as an equity investment, for example by way of share subscription.

Margin loan restrictions do not usually affect the debt financing of private equity transactions in Ireland.

#### 11 Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in a going-private transaction? What other documents set out the expected financing?

There are no specific going-private financing documents and generally the debt and financing documents include a facility letter, a loan agreement (syndicated or otherwise) and related security documents. Typical provisions include mechanical provisions that set out the actual terms of the deal and the day-to-day matters governing the loan, representations and warranties of the borrower, general and financial covenants, and events of default.

#### 12 Fraudulent conveyance issues

Do private equity transactions involving leverage raise 'fraudulent conveyance' issues? How are these issues typically handled in a going-private transaction?

Should a seller dispose of an asset substantially below value there may be concerns, particularly if there is any relationship between the seller and the buyer. Notwithstanding the consideration paid for the undervalued asset, the Irish revenue commissioners shall take into account the market value of the asset in determining the relevant tax liabilities.

However, taking into account that most buyouts take place by auction in accordance with the rule and procedure determined by the seller's investment bank, few concerns are raised.

#### 13 Shareholders' agreements

What are the key provisions in shareholders' agreements covering minority investments or investments made by two or more private equity firms?

The main provisions relate to corporate governance, information rights, transfer restrictions and exit provisions (including tag-along and drag-along rights).

A private equity firm will also aim to obtain a level of management control of the target and would include control measures in the shareholders' agreement such as: the right to appoint a director;

a special core of requirements at board meetings; vetoes over a wide range of investee company actions; a right to require the investee company to enforce its rights against an employee under the employee service agreement; extensive rights to access and receive information; and the right to examine the investee company books with their professional advisers. There may also be restrictions on management in shareholders' agreements requiring the management of the target to transfer their shares when they leave the company.

#### 14 Limitations on transaction size

Do private equity firms have limitations on the size of transactions they may engage in?

There are no statutory limitations but different private equity firms concentrate on different size of transactions.

#### 15 Exit strategies and investment horizons

How do the exit strategies and investment horizons of private equity firms affect the structuring and negotiation of leveraged buyout transactions?

The structure of the debt package will be influenced by the investment horizon of the private equity firm. The following forms of exit are commonly used to realise an investment in successful companies:

- trade sales: this is convenient and the most common form of exit;
- IPOs: because of the activity in the markets in recent years, IPOs are commonly used as an exit mechanism. The amount of equity to be disposed of in an IPO, and the length of any lock-up period, is negotiable; and
- secondary buyouts: these have become more common, especially when combined with a recapitalisation.

#### 16 Principal accounting considerations

What are some of the principal accounting considerations for private equity transactions?

The impact of the Sarbanes-Oxley regulations on the services provided by accountants to private equity firms, the new International Accounting Standards that came into force on 1 January 2005 for certain companies and the issues faced by the challenge of what the International Financial Reporting Standards mean when compared to Irish GAAP are considered in respect of private equity transactions. Other material accounting issues include the establishment of pension deficit figures for deferred pension schemes and any potential restructuring or redundancy costs.

#### 17 Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years?

In recent years, the targets have been typically property-based, relating to circumstances whereby the value of listed companies do not genuinely reflect the value of the underlying assets or properties.

#### 18 Industry-specific regulatory schemes

Do industry-specific regulatory schemes limit the potential targets of private equity firms?

No. However, additional regulatory consents or licences may be required in respect of the acquisition of securities in certain industries, for example, the pensions, insurance and financial services industries.

### Update and trends

Irish companies continue to attract interest from international and Irish-based private equity funds, with the technology and medical devices sectors benefiting most over the past 12 months. In December 2008, the Irish Government announced that up to €500 million will be generated to create a venture fund, known as 'Innovation Fund – Ireland', to support early stage R&D intensive SMEs.

A number of turnaround opportunities are now emerging in the current turbulent market due to forced sellers; structural change in the market; and debt binge.

### 19 Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or private equity transaction?

There are often legal limitations on guarantees given by companies incorporated outside Ireland, and cross-border issues may arise in respect of the security provided. Legal opinions from the relevant jurisdictions should be considered.

### 20 Club and group deals

What are the special considerations when more than one private equity firm (or one or more private equity firms and a strategic partner) is participating in a club or group deal?

The parties to such a syndicate will consider the proportions of investments, priority on returns, the weighted obligations and the respective voting and management rights.

### 21 Recent credit market disruptions

How have disruptions in the credit markets affected dealmaking?

What specific changes to transaction terms have you seen and do you expect in the future?

Disruptions in the credit markets have halted the rise in private equity deals and leveraged buyouts, particularly in the context of larger transactions. The difficulties experienced in respect of the valuation of assets and obtaining debt is consistent with the uncertainties currently being experienced globally and have added to the significance of terms relating to earn out structure mechanisms and covenants in security documents issued by lenders. Venture capital funding held up reasonably well in 2008 despite a shortage of liquidity across the financial sector in general.

It would be reasonable to anticipate more dealmaking involving trade buyers and possibly fewer private equity buyers, particularly where the trade buyers have strong balance sheets.

We would expect vendors to focus at an early stage in more detail on prospective purchaser capacity to complete, with a more particular focus on bank letters of support as part of the auction process.

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