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Private equity deal making post-AIFMD: notification and disclosure rules

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1. Introduction

The Alternative Investment Fund Managers Directive (2011/61/EU) contains rules requiring the notification and disclosure of information by private equity firms in the case of an acquisition of a major holding or control over a non-listed company having its registered office in the EEA.

The rules apply to deal making activity by firms authorised under the Directive or which market their funds to EEA investors, and must therefore be borne in mind by managers working at such firms when acquiring or ceasing to hold a major holding or control over a portfolio company.

The majority of private equity firms in the UK which have applied to become authorised under the Directive are expected to become authorised on or shortly before 22 July 2014. The full impact of these rules will therefore begin to be felt from such date.

This note provides a summary of the relevant rules and explains what their impact is expected to be.

2. What are the notification rules?

The Directive provides that when a private equity fund acquires, disposes of or holds shares of a non-listed company having its registered office in the EEA, the manager of that fund must notify the competent authorities of its home member state (i.e. the FCA in the case of a UK manager) of the proportion of voting rights of the non-listed company held by the fund any time when that proportion reaches, exceeds or falls below the thresholds of 10%, 20%, 30%, 50% and 75%.

In addition, when the fund acquires, individually or jointly with others, control (i.e. more than 50% of the voting rights) over a non-listed company having its registered office in the EEA, the manager managing such fund must notify the following persons of such control:

(a) the non-listed company;

(b) the company's shareholders of which the identities and addresses are available to the manager; and

(c) the competent authorities of the home Member State of the manager.

The above notification must contain the following additional information:

(i) the resulting situation in terms of voting rights in the company;

(ii) the conditions subject to which control was acquired, including information about the identity of the different shareholders involved, any person entitled to exercise voting rights on their behalf and, if applicable, the chain of undertakings through which voting rights are effectively held; and

(iii) the date on which control was acquired.

In its notification to the non-listed company, the manager must request the board of directors of the company to inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the acquisition of control by the fund and of the information referred to above, and must use its best efforts to ensure the board of directors complies with its request.

All of the above notifications must be made as soon as possible, and in any case no later than 10 working days after the date on which the fund reaches, exceeds or falls below the relevant threshold or acquires control over the non-listed company.

3. What are the disclosure rules?

The Directive provides that when a private equity fund acquires, individually or jointly with others, control (i.e. more than 50% of the voting rights) over a non-listed company having its registered office in the EEA, the manager of the fund must make certain information available to:

(a) the company concerned;

(b) the shareholders of the company of which the identities and addresses are available to the manager;

(c) the competent authorities of the home member state of the manager; and

(d) where the company has its registered office in an EEA state other than the UK, in certain cases, the competent authorities of the EEA state where the company has its registered office.

The information to be made available is:

(i) the identity of the manager which either individually or in agreement with other managers manages the fund or funds that have acquired control;

(ii) the policy for preventing and managing conflicts of interest, in particular between the manager, the fund and the company, including information about the specific safeguards established to ensure that any agreement between the manager and/or the fund and the company is concluded at arm's length; and

(iii) the policy for external and internal communication relating to the company in particular as regards employees.

In its notification to the company, the manager must request the board of directors of the company to give the employees' representatives or, where there are none, the employees themselves, without undue delay the information referred to above, and must use its best efforts to ensure that the board of directors complies with its request.

In addition, the Directive provides that when a private equity fund acquires, individually or jointly with others, control of a non-listed company having its registered office in the EEA, the manager of the fund must ensure that within a period of 20 working days the fund, or the manager acting on behalf of the fund, discloses its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment, to:

(a) the non-listed company; and

(b) the shareholders of the non-listed company of which the identities and addresses are available to the manager.

Once again, the manager of the fund must request the board of directors of the non-listed company to make available the relevant information to the employees' representatives or, where there are none, the employees themselves, of the non-listed company, and must use its best efforts to ensure that the board of directors complies with its request.

Lastly, the Directive provides that when a fund acquires control of a non-listed company having its registered office in the EEA the manager of that fund must provide the competent authorities of its home Member State with information on the financing of the acquisition.

4. What impact are these rules expected to have?

4.1 Confidentiality Concerns

It appears that the notification and disclosure rules require the disclosure to a company's employees or employee representatives of information (such as the holding of voting rights within a private equity fund or the future business plans of a portfolio company) that, in accordance with current practice, is generally treated as confidential and is not therefore disclosed outside of a restricted number of individuals who are involved in a transaction.

In certain cases, the disclosure of such information could be prejudicial to a private equity firm or a portfolio company while being of no or limited benefit to the portfolio company's employees or employee representatives and it is currently unclear to what extent such information could be withheld from the wider workforce of a portfolio company without contravening the AIFMD rules.

We are hopeful however that a practice will develop whereby such information would not have to be disclosed to the company's employees, or at least would have to be disclosed only to a restricted number of such employees.

The AIFMD provides, for example, that where the disclosure of information would seriously harm the functioning of a non-listed company, or would be seriously prejudicial to it, the board of directors of the portfolio company is not obliged to make such information available to the company's employees or employee representatives.

Such exemption, however, (i) does not appear to prevent the board of a portfolio company from making such information available if it so wishes and (ii) does not apply in respect of information the disclosure of which would seriously harm the functioning of the private equity firm (as opposed to the portfolio company) or be seriously prejudicial to it.

It is therefore unclear to what extent such exemption could be used to avoid having to disclose information that it would be in the interest of a private equity firm, rather than a portfolio company, to keep as confidential.

In our view, at least in certain cases, it may be possible to arrange for the relevant information to be provided only to one or two individuals, who could be appointed as the company's employee representatives for the purposes of the AIFMD, on terms requiring such individuals not to make the relevant information available to the wider workforce unless they reasonably believe that it would be in the best interest of the company to do so.

4.2 Notification Rules

Other than as set out above, the notification requirements concerning the acquisition or disposal of major holdings are not expected to give rise to any particular issues in the context of an acquisition or disposal by a private equity firm of a portfolio company.

The legal advisors acting for the private equity firm will usually be able to prepare the relevant notification relatively quickly and without the need to obtain any additional information from the target company or the private equity managers.

In addition, the relevant notification is not expected to be particularly lengthy and therefore the costs of preparing such notification will not generally be significant. It is important however that the parties do not overlook making the notification within the prescribed deadline, which is 10 working days from the date the acquisition or disposal of control has taken place.

Since the rules require a manager to use its "best efforts" to ensure that the board of the portfolio company makes available the disclosed information to the company's employees, it has been suggested that a clause requiring the board to do so should be included in the investment agreement concerning the portfolio company.

We would suggest however that, rather than including a clause specifically dealing with compliance with the notification and disclosure rules, a clause dealing generally with AIFMD compliance be included in the agreement.

Such clause, for example, could be worded as follows: "the Company, its Subsidiaries and their respective Officers and Directors shall take such steps as may from time to time be reasonably required by the Manager in order to ensure that the Manager complies with its obligations under the Alternative Investment Fund Managers Directive (2011/61/EU)".

We expect that such clause will become a staple of any private equity investment or shareholders' agreement.

It is also worth noting that a notification may be required not only where the percentage of voting rights held by a fund in a portfolio company changes as a result of the acquisition or disposal of shares in that company but also where such percentages changes as a result of events altering the number of total voting rights in issue without any acquisition or disposal of shares by the fund having taken place. This happens in practice quite often when management teams undertake planning for entrepreneurs relief purposes.

4.3 Disclosure Rules

As far as compliance with the disclosure rules is concerned, the position is in summary as follows.

Managers of private equity funds will be required for the first time to prepare, and disclose to the relevant parties, a policy for preventing and managing conflicts of interest between the manager, the fund and the target company, which must include information about the specific safeguards established to ensure that any agreement between the manager and/or the fund and the company is concluded at arm's length.

Our expectation is that managers will choose to incur a one-off cost for preparing a standard conflicts of interest policy which they will then utilise with minimum or no tailoring every time they acquire control over a new portfolio company.

Such policy should address, as a minimum, topics such as fiduciary duties for investor directors, relationship between different portfolio companies, distributions of value from portfolio companies and exits.

The policy must in addition include information about the specific safeguards established to ensure that any agreement between the manager and/or the fund and the company is concluded at arm's length.

It will be interesting to see in this respect what market practice will develop for the purpose of justifying the level of monitoring or directors' fees payable by portfolio companies. Such fees could, for example, be set at a level equivalent to the fees payable by comparable listed companies to their non-executive directors.

Transaction fees will also have to be justified by reference to market practice so that there can be no accusation that such fees have been set at an abnormally high level.

Similarly, our expectation is that managers of private equity funds will choose to incur a one-off cost to prepare a policy for external and internal communications relating to portfolio companies in particular as regards employees, which they will then utilise with minimum or no tailoring in respect of every portfolio company they acquire.

The requirement to disclose to the portfolio company the manager's intentions with regard to the future business of the company and the likely repercussions on employment will, by contrast, require specific consideration and drafting, at least in certain circumstances. Since however, at least in the UK, the relevant disclosure can be made up to 20 working days after the acquisition of control has taken place, it will be possible most of the times to prepare the relevant disclosure after completion has occurred.

The requirement to disclose to the competent authorities information on the financing of the acquisition may also result in additional legal costs but the lawyers who have acted on the acquisition should generally be able to prepare the relevant disclosure without requiring any significant input from the managers.

For completeness, it is worth noting that specified information regarding the development of a portfolio company's business must also be included in the fund's annual report or the annual report of the portfolio company and made available to the portfolio company's employees.

The introduction of these additional disclosure requirements might ultimately result in the demise of the Walker Guidelines for Disclosure and Transparency in Private Equity in the UK.

5. To which managers do these rules apply?

Broadly speaking, the notification and disclosure rules apply to the following categories of private equity managers:

(i) UK and EEA managers that have been authorised as AIFMs under the Directive; and

(ii) non-EEA managers that have notified the FCA (or the equivalent competent authorities of another EEA state) of their intention to market their fund to investors based in the UK (or such other EEA state).

Accordingly, the rules do not apply to the following categories of managers:

(i) managers of private equity funds that qualify as "small AIFMs" for the purposes of the Directive (i.e., in summary, managers who have assets under management of less than €500m and manage unleveraged closed-ended funds having no redemption rights within five years);

(ii) non-EEA managers of private equity funds established outside of the EEA which are not marketed to EEA-based investors.

As mentioned, since the majority of private equity firms in the UK which have applied to become authorised under the Directive are expected to become authorised on or shortly before 22 July 2014, we anticipate that the full impact of these rules will begin to be felt from such date.