WHAT IS BREXIT?
Most people will now be familiar with the British referendum which took place on June 23rd 2016, when the British public voted for the UK to leave the European Union (EU). The EU currently consists of 28 European countries who somewhat make up a “United States of Europe” but crucially maintain their own languages, cultures and in some cases currency. Laws within the EU are a mixture of local domestic laws and EU wide laws (some of which apply directly and others which need to be implemented into domestic laws). The outcome of the vote was a surprise and initially shook the European and international stock markets. Much has been written and commented about how and when the British withdrawal process will happen and what the UK’s relationship with the EU will look like post-Brexit. However, whilst the British Prime Minister, Theresa May formally started the withdrawal process by activating Article 50 of the Lisbon Treaty on March 29th, the UK remains part of the EU until the UK and the EU conclude their exit negotiations over the coming two years to agree the terms of the ongoing trading relationship between the two; which could take many shapes.

The outcome of the withdrawal process will have far-reaching consequences for international companies already invested in the UK and for those planning to expand operations into Europe. Equally, international investors will need to consider whether to alter their European investment strategy.

Since the dilemma as to what to do next varies....

>> Continued on Page 6
Message from the Chair

Hello and welcome to the revamped version of Preferred Returns! With many thanks to new editor Brett Stewart for all of her hard work, we have tried to update the format of this newsletter with the goal that the newsletter better serve as a guide for the upcoming Committee meetings, as well as for the work of our Committee generally. Thank you, Brett!

This is the first meeting since I became Chair of the Committee last fall. In the six months or so since then, one thing has become abundantly clear to me – our prior Chair, Jon Gworek, was simply an amazing leader. Thanks to all of the time and hard work Jon dedicated to our Committee, our Committee is one of the largest, most active committees of the Business Law Section. And thanks to Jon’s personal friendship and mentoring, the handover has been seamless. On behalf of myself and the full Committee, thank you to Jon for all he has done and all he will continue to do in his new capacity as Chair of our Programming Subcommittee.

Our sponsors for the 2017 Spring Meeting are Houlihan Lokey and SRS Acquiom. Thanks to their sponsorship, we have a fantastic dinner planned on Thursday, April 6, beginning at 7:15 at Palace Café (605 Canal Street), including live music from the Blodie Trio. We reserved a larger event space for this dinner than we have for previous meetings (55 seats) and still are sold out! Please join me in thanking Houlihan and SRS for their support.

Building on the momentum Jon created, since the 2016 annual meeting, we have expanded our leadership so that each subcommittee now has two co-chairs. In addition, we have created an Academic Subcommittee (that will first meet at the 2017 annual meeting in Chicago) in the hopes of facilitating communication among academics, judges and practitioners who work in the PE/VC space. Finally, we have joined with the Corporate Governance Committee and Middle Markets and Small Business Committee in working on a new Contractual Governance of Business Entities Joint Task Force. As you read through this issue of Preferred Returns, you will get a sense of what each of our subcommittees is working on.

In addition to all of our subcommittee meetings, we have a full agenda at our main committee meeting, including a discussion with Chief Justice Strine of the Delaware Supreme Court regarding director independence, particularly in the VC space. We also are sponsoring two CLE Panels. The first panel, Socially Responsible Venture Investing (Thursday, 10:30-12:00), will focus on corporate structures that help investors ensure that their investments have positive social and environmental impact, as well as provide a financial return.

The panel will include lawyers in private practice with significant experience in negotiating investments in socially responsible companies, the general counsel of an Austin-based Delaware public benefit corporation that recently closed a Series B round, and the Head of Legal Policy at B Lab. The second panel, Valuation Scenarios in the Lifecycles of a VC Backed Company (Friday, 3:30-5:00), will focus on valuation and process considerations at three stages of a VC Backed Company – initial investments, additional rounds of financing, and exits. The panel was designed to address issues from varying viewpoints, and includes two financial advisors, a Silicon Valley-based attorney, and a recently retired Vice Chancellor of the Court of Chancery (Hon. John Noble), who authored several of the key VC-related opinions of the past decade.

I encourage anyone who would like to take a more active role in the Committee generally, or in any of our subcommittees, to reach out to any member of our leadership team. We’d love to have your involvement! In the meantime, I look forward to seeing you in New Orleans!

Eric Klinger-Wilensky
Chair
Looking Ahead to New Orleans

→ What the Committee Has in Store

Among other agenda items, Chief Justice Strine of the Delaware Supreme Court will be discussing with us some recent caselaw, along with his views generally, on director independence – particularly in the VC space. For those of you not able to join us in person, we welcome your participation in our meetings by telephone. The dial-in number for all of our committee and subcommittee meetings in New Orleans is 866.646.6488 from the U.S. and Canada and 707.287.9383 from all other countries.

David Louis of Charles Russell Speechlys will explain how to navigate the structuring of a PE investment through Luxembourg entities, taking the latest updates into account and using a concrete example featuring a US investment manager targeting European companies, Todd Boudreau of Foley & Lardner LLP will present on upcoming changes to the Private Equity space due to the Trump Administration, and Benedict Kwon of Stradling Yocca Carlson & Rauth, P.C. will present regarding some recent changes to US tax laws related to leveraged blockers used by non-US funds investing in the US.

The main discussion will be on special issues and drafting considerations that arise in “Strategic/Corporate VC” rounds of financing. Hosted by subcommittee Chairs Scott R. Bleier (Morse, Barnes-Brown & Pendleton, P.C., Boston, MA) and Joshua D. Geffon (Stradling Yocca Carlson & Rauth, P.C., Santa Barbara, CA), who will also discuss recent or pending modifications to the NVCA forms.

Our topic will be Entrepreneurship and Angel Investing in New Orleans and Louisiana. We will discuss deal flow, terms and trends, and local initiatives in the New Orleans angel investing ecosystem. Speakers will include Michael Eckert: Chairman of New Orleans/Louisiana Angel Network and board member of the Angel Capital Association Mark Graffagnini: Founder and Managing Partner of Cara Stone LLP; Founder of Louisiana Venture and Angel Capital Report.

Following past practice, the International Subcommittee of the PE/VC Committee will invite short presentations by our international members regarding topics of interest to the PE and VC community from an international perspective. For this meeting we have lined up presentations on Switzerland, Japan and views on Brexit, among others. We look forward to seeing you at the meeting!
A new Academic Subcommittee has been organized to encourage interaction between the PEVC Committee and its programs, and the group of corporate law professors who teach and write about venture capital and private equity. The Subcommittee will convene for the first time at the September meeting. Bill Bratton of the faculty of the University of Pennsylvania Law School and Brian Broughman of the faculty of the Maurer School of Law at Indiana University Bloomington are serving as the co-chairs and presently are planning a program for September.

We have two fantastic CLE panels planned.

1. Socially Responsible Venture Investing: Corporate Structure and Special Considerations
   - Thursday – April 6 (10:30 AM – 12:00 PM)
   - Strand 12A, Level Two
   - This CLE panel will focus on corporate structures that help investors ensure that their investments have positive social and environmental impact, as well as provide a financial return. The panel will include lawyers in private practice with significant experience in negotiating investments in socially responsible companies, the general counsel of an Austin-based Delaware public benefit corporation that recently closed a Series B round, and the Head of Legal Policy at B Lab. As reflected in the table below, this program follows a program we are cosponsoring on Financing Environmentally Friendly Projects and Green Bonds. The programs are in the same room, so you can obtain 2 ½ hours of CLE credit from panels touching on socially responsible investing without having to leave your seat!

2. Valuation Scenarios in the Lifecycles of a Venture Capital Backed Company
   - Friday – April 7 (3:30 PM – 5:00 PM)
   - Strand 10A, Level Two
   - Valuation Scenarios in the Lifecycles of a VC Backed Company will focus on valuation and process considerations at three stages of a VC Backed Company – initial investments, additional rounds of financing, and exits. The panel was designed to address issues from varying viewpoints, and includes two financial advisors, a Silicon Valley-based attorney, and a recently retired Vice Chancellor of the Court of Chancery (Hon. John Noble), who authored several of the key VC-related opinions of the past decade.

Please see schedule of events below for other great CLE panels being co-sponsored by our committee.
A recent judgment of the Federal Court, the highest Swiss judicial instance, calls into question the conventional wisdom among M&A practitioners that, in the interest of an expeditious resolution, the parties should appoint an independent expert to decide on the amount of the post-closing purchase price adjustment in case of disagreement between the parties.

In M&A transactions with a post-closing adjustment of the purchase price (most commonly for cash, debt and net working capital), it is common practice to provide that, if the parties cannot agree on the amount of the adjustment within a certain time, an independent expert (usually an accounting firm) shall render a final decision on the adjustment amount. Typically, the relevant SPA provisions allow one party (usually the buyer) to prepare a draft of the calculation of the purchase price adjustment. If the other party disagrees with the amount, it has to give a formal notice of objection within a certain time limit, and if the parties are not able to reconcile their differing calculations, either party may refer the matter to the expert. The third party to act as expert either is already agreed in the SPA, or the parties have to mutually appoint the expert at that time; if they fail to do so, each party may request a neutral institution (such as a local chamber of commerce or court) to determine the expert.

This approach is so commonplace that it is hardly ever discussed in principle in the negotiations. The expectation of the parties is that the expert proceedings will resolve a dispute with regard to the final purchase price substantially faster than full-fledged court or arbitration proceedings. However, this may actually not be the case in Switzerland.

The Swiss Federal Court has now confirmed that an independent expert can only be appointed to assess matters of fact, but not matters of law. The latter also include any disputed issue which requires the interpretation of contractual clauses. Therefore, the expert is in particular not competent to assess the validity of the notice of objection. The same applies to any contractual agreements that the parties may have made with regard to certain valuation issues (e.g. normalization of EBITDA). Further, many Swiss target companies prepare their financial statements in accordance with the accounting rules provided by Swiss corporate law instead of accounting standards prepared by a private institution (such as IFRS); arguably, any discretionary accounting assessments to be made based on these corporate law accounting rules (for instance provisions for outdated stock) are also matters of law. As a consequence, the party ordered to make an adjustment payment by the expert has various possibilities to argue that the expert has exceeded the scope of its competence, thus forcing the other party to address the competent court in order to obtain a binding decision on the matters in question.

Further, the Swiss Federal Court has also confirmed that the decision of the independent expert does not constitute an enforceable judgment. Therefore, if the party ordered to make an adjustment payment refuses to pay (even without raising the “matters of law defense”, or without giving any reason at all), the claimant cannot initiate debt enforcement proceedings directly based on the expert’s decision, but rather first has to initiate court proceedings, asking the court to order the defendant to make the payment assessed by the expert.

Therefore, it is at least questionable whether an expeditious resolution of purchase price adjustment disputes may be achieved by relying on the usual independent expert mechanism. Depending on the circumstances, a party believing to be entitled to an adjustment payment should consider the alternative of directly filing a lawsuit in the competent court. Both state courts and arbitration panels have the possibility to appoint court experts for valuation questions, and if the SPA provides for arbitration, arbitrators with relevant accounting expertise can be appointed. The other party may then still argue that the independent expert provisions of the SPA are mandatory (in the sense that the competent court may not be addressed directly); therefore, parties should carefully consider whether they still want to include such provisions in their transaction agreements at all.

THE SWISS FEDERAL COURT HAS NOW CONFIRMED THAT AN INDEPENDENT EXPERT CAN ONLY BE APPOINTED TO ASSESS MATTERS OF FACT, BUT NOT MATTERS OF LAW.
THE UK VIEW

The wartime slogan of “Keep Calm and Carry On” has been used a lot in the last few months. Both the UK Government and business leaders are doing their utmost to provide a background of stability and counter the initial fluctuations in the stock markets and exchange rates seen in the immediate aftermath of the vote. They have been relatively successful in maintaining that calm and a wholesale recession has currently been avoided. To provide reassurance, the Government issued a White Paper in February providing an overview of the areas of importance to them as part of the exit, but clearly these were high level so as not to give away their hand before negotiations had started.

Leading reasons for overseas businesses setting up their European presence in the UK have included:

- an English speaking market
- a familiar business culture
- access to the 500 million consumers within the EU single market
- access to a talented and well-educated workforce from across continental Europe
- whilst the UK remains a member of the EU, UK-based companies continue to benefit from the EU’s “four freedoms”: the free movement of goods, of workers and citizens, of capital, and the freedom to establish and provide services

The British Venture Capital Association reports investment levels are down year to date (which of course includes the period pre-Brexit vote which created some uncertainty) and reflects 2009 levels. Investments in the UK from the EU account for approx. 15% of both value and number of deals and a question remains on whether those will be affected going forward.

Post-Brexit Britain is impossible to currently define but there are two major issues which US investors and businesses will need to consider:

1. Will the removal of “free movement of people” materially impact their strategy? Currently EU citizens can move around the 28 countries without the need for work permits or visas and so many British companies rely on EU workers (including at the most senior levels). There is no clarity on whether the right will be completely removed or varied but since it was the emotive basis for many of voters supporting the “Leave” campaign, it’s likely to change. However, it will simply mean that EU workers will need immigration status in the same way as US or Canadian workers currently need a visa or work permit when working in the UK. Sponsor Licences will support workforces from around the world and our advice is to apply for one sooner rather than later – simply because there will be a spike in applications the nearer to the effective date of the exit.

2. Whilst many EU laws are already domestic laws in the UK, it is expected that some of these will be varied or replaced entirely. The UK government has been extremely supportive of overseas investment and entrepreneurialism over many years and so it is anticipated that any changes will be business friendly. However, it should also be borne in mind that the changes will need to be made with a view to an ongoing trading relationship with the EU and so to make that work, moderate adjustments and retaining some of the more important EU regulations (eg data protection) are likely to be retained.

Generally the sentiment of the investment community in the UK has remained bullish and whilst some uncertainty remains around the exact detail of how the Brexit will impact on every aspect of doing business in the UK, the strength of the market and the international relationships that it already maintains will put the
INTERNATIONAL BUSINESSES SHOULD ESTABLISH A PRESENCE IN ONE OF THE REMAINING 27 EU MEMBER STATES TO BE WELL PREPARED FOR BREXIT’S OUTCOMES

UK in a strong position for an ongoing position within the global market.

THE EU VIEW
Once Brexit becomes effective, the UK will no longer benefit from being part of the EU and whilst the EU and the UK will have a mutual interest to maintain close trading relationships post-Brexit, it is heavily doubted that such negotiations will result in the UK having full unfettered access to the EU single market and benefitting from the EU’s “four freedoms”. Currently, the UK only grants ac-cess to its single market to such non-member countries (like Norway, Iceland or Liechtenstein) which implement fundamental EU legal standards within their jurisdictions. Though gaining autonomy from EU laws was one of the main drivers for the British leave vote, it is not expected that the free movement of workers will continue to apply. Restrictions on the access of employees and their families to the UK (and, in return, to the EU) will necessarily affect recruitment practices, the pool of talent available and the movement of employees between the UK and the EU. In addition, the introduction of customs on certain goods cannot be ruled out.

If access to the EU single market is an essential objective for an investment into an EU business or a corporate expansion into Europe, international businesses should establish a presence in one of the remaining 27 EU member states to be well-prepared for Brexit’s outcomes. At this time, the location within the borders of the remaining EU is the only reliable approach for a European operation to safeguard the benefits of the EU single market.

Where there is a strategic objective to target both the UK and the EU Single Market, it is advisable to consider establishing a presence in both jurisdictions (subject to an optimized group structure). VCs having their European funds domiciled in the UK may need to consider the impact of Brexit on their passporting rights around the EEA (a slightly wider group of countries which includes non-EU countries) and consider the need to re-domicile or create new fund structures within the EU unless the UK’s negotiations include retaining those passporting rights as a non-EU member.

Among the remaining 27 EU member states, it will not be difficult to identify suitable locations for a subsidiary or target. Germany, France and the Netherlands are founding members of the EU and guarantee – despite certain domestic anti-EU movements in the two latter countries – to remain within the EU single market so long as it exists. Germany is Europe's biggest economy and provides a first class infrastructure in the very centre of the EU map. It is well-connected by international airports (Frankfurt) and is home to one of Europe's most important start-up hubs in Berlin which attracts talented entrepreneurs from all over the world. The funding of German companies has seen a significant growth in the past three years outpacing other European tech regions including pre-Brexit UK.

Amsterdam and Paris are international trade hubs with the former offering a local workforce with high-quality English language skills. Dublin (Ireland) or Stockholm (Sweden) are other popular destinations within the EU depending on the business objectives of the corporation.

Establishing subsidiaries and providing efficient tax structures is straightforward in all of the abovementioned countries and US style financing rounds have been successfully closed for many years. Taking Germany as an example, whilst some domestic laws apply to an investment in a German company, the structure of a financing round would essentially include legal, tax and financial DD and the negotiation of an investment and shareholders’ agreement in English containing many US standard reps and warranties.

The German federal government as well as many regional and local institutions around the country subsidize investments in local companies even by foreign investors. German VC funds often serve as co-investors for overseas investors.

WHAT’S THE RIGHT DECISION?
Overseas investors and businesses need to consider why they are expanding into Europe: are they targeting the UK for its market and familiar business culture: if so, nothing has changed, nor will it materially change once it exits the EU. However, if access to the EU single market is key, then a post-Brexit presence within one of the remaining 27 EU member states is likely to be the preferred option. However, if you’re looking for both, then the safest option is simply to establish a presence both within the UK and within one of the remaining EU member states. It’s therefore a different way of looking at European Investment/ expansion but ultimately life will go on and structuring will become the new normal.
Reserved Alternative Investment Fund (RAIF):  
the new investment vehicle to raise capital for US PE/VC sponsors

On 14 July 2016, the long awaited Reserved Alternative Investment Fund (RAIF) law (“the RAIF Law”) was voted in. The RAIF is considered by certain practitioners as the ultimate investment vehicle completing the Luxembourg toolbox.

Indeed its flexibility and its lightly regulated aspects seem to be the greatest arguments in attracting the already numerous sponsors (in terms of market shares of fund initiators by country of origin in terms of assets under management, US sponsors represent the main sponsors of Luxembourg investment funds with 20.7%).

It is now clearly a fact that Luxembourg is on the map in the PE/VC world as one of the jurisdictions of predilection. Indeed, the largest PE/VC sponsors are based in Luxembourg (Bridgepoint, Blackrock, CVC, Oaktree, Carlyle, TPG, etc.) and have set up a lot of investment funds. Some of them have decided to locate their European hub in Luxembourg (and more think about it since the Brexit announcement).

**WHY DO THE PRACTITIONERS THINK THAT IT WILL BE SO SUCCESSFUL?**
An investment fund provides for a lot of benefits but is generally regulated and not specific to certain types of investment policies. In Luxembourg, there has been a willingness to build up a dedicated framework for mainstream investment strategies (SICAR for PE/VC, UCITS for retail fund; there is also a project to create a REIT regime). All these regimes entailed the acceptance and supervision of the Commission de Surveillance du Secteur Financier (CSSF) (Luxembourg supervisory authority) which gives confidence to investors and therefore helps sponsors in terms of capital raising. However, this acceptance process might have been seen as a hurdle to the time taken to market a product. Since the AIFMD, the manager’s side is supervised by the CSSF. The question is therefore whether it is useful to have a double layer of regulation (i.e. product and managers). In certain cases it is useful as the investors want to have a fully supervised investment scheme (product and manager), but on other occasions the supervision layer at the level of the manager grants enough confidence to the investors.

**WHAT ARE THE KEY ELEMENTS TO TAKE AWAY?**
A number of elements lead to think that it would be a perfect balance between regulation and flexibility for various reasons as explained below.

**Supervision: Enhanced time to market**
The RAIF Law provides a legal framework which has the benefits of an Alternative Investment Fund, but without falling per se under the supervision of the CSSF, which will therefore reduce the time to market.

At the same time, as an authorised Alternative Investment Fund Manager (AIFM) is being appointed by the RAIF, it will ensure that these types of funds will not be totally unregulated, which will likely boost the confidence of potential investors.

**Known structure: a solid history**
A RAIF will be very similar to a Specialized Investment Fund (SIF) and the investment company in risk capital (SICAR). Indeed, a RAIF keeps the advantages of a SIF/SICAR, notably:

- Creation of compartments
- EU passport for marketing its interest, shares or units
- Full flexibility of legal forms
- No limitation in terms of investment policy (for the SIF)

The SIF law was first introduced in 2007 and has been extremely successful in streamlining the rules around establishing investment fund structures, as well as providing a means to ensure that SIFs are registered.

The SICAR law was enacted in 2004 and until now it was one of the preferred types of investment fund of PE/VC while envisaging to structure an investment vehicle with the purpose of raising capital in the European Union.

However, the RAIF law builds upon existing legislation to add a new layer of flexibility to that already offered by SIFs/SICARs.

Contrary to SIFs (and provided it does invest in risk capital as per the law, as for the SICARs), RAIFs will not have to comply with the risk diversification requisite. In all other cases, these funds will have to follow the diversification risk obligations (the 30% rule).

**EU Passport**
Furthermore, by virtue of being indirectly regulated through AIFMs, RAIFs might benefit from the EU passport to market its shares, interests or units throughout the Union.

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1. David Louis is a Partner | Avocat à la Cour for and on behalf of Charles Russell Speechlys in Luxembourg.
2. This article is focused on the TopCo side being the investment vehicle in order to pool investors into the investment policy envisaged, usually an investment fund. The part concerning the structuring below an investment fund has been tackled during previous Business law Committees CLEs.
3. Luxembourg is the leading investment fund centre in Europe and the second largest in the world after the US.
4. For instance, AIFMD was drafted first with a view to mainly regulated hedge funds which was not in line with the PE/VC or real estate models.
5. The SICAR was created in 2004 in order to attract PE/VC initiators in Luxembourg. It is a dedicated investment vehicle for PE/VC investment policies.
6. The SICAR can only be elected if its investments are in risk capital (i.e. PE/VC).
WHY IT SHOULD BE OF INTEREST FOR THE ASSET MANAGERS?

The asset managers have two main concerns: the proper management of their assets and the marketing of their product.

With the first one, the lawyer can assist them by putting an adapted framework to develop their management; the rest is what they are good at. The second depends on multiple criteria which include the broadening of scope of the investor’s base in clear, known and efficient schemes.

By setting up a RAIF, the asset manager will benefit from the advantages mentioned above and will open new opportunities to welcome new investors.

Usually, when an asset manager has been successful in the US by the launching of one or several fund(s), they tend to go outside the US and this is where a RAIF is a real solution.

WHY SHOULD IT BE OF INTEREST FOR US BUSINESS LAWYERS?

The investment management business is becoming more and more international and facilitated by different media and platforms. Therefore, the lawyer advising the asset manager is asked more and more to find new solutions, and in certain cases the local solution should be combined with a solution from abroad. That is where the US lawyer relies on their network to find out such solutions and where the RAIF might help him to satisfy the expectations of their clients.

- Thank You -

Thanks to our generous sponsors we have a fantastic dinner planned for the Private Equity and Venture Capital Subcommittee on Thursday April 6, 2017 at 7:15 p.m.

The dinner will be held at Palace Café (605 Canal Street) and is a sold-out event.

It promises to be a fun night and will include live music from the Blodie Trio.

Please join us in thanking our sponsors, Houlihan Lokey and SRS Acquiom,

for making this dinner possible.
The Committee is collecting articles for future newsletters which are circulated to our members worldwide. Please send your submissions to Brett Stewart at brett.stewart@mcmillan.ca

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.