If your practice is focussed on private equity fund formation, or if you regularly act for investors in private equity funds, then you know by now that the Institutional Limited Partners Association (“ILPA”) has published a third version of its principles that set out ILPA’s view of industry best practices.1 Titled “ILPA Principles 3.0: Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners” (“ILPA 3.0”), this latest edition of the principles was published in June 2019.

HISTORY OF THE ILPA PRINCIPLES

The first ILPA principles were published in September 2009. After consultation with the GP and LP communities, a further refined version of the principles was published in January 2011 (“ILPA 2.0”). According to ILPA’s website, ILPA 3.0 “builds on prior versions by addressing an expanding array of issues, taking into consideration evolving industry and policy dynamics impacting private equity fund partnerships.”2 Unlike ILPA 2.0, “ILPA will not be seeking official endorsements for ILPA 3.0, but will be encouraging industry-wide adoption of its tenets.”3 This approach suggests that ILPA 3.0 is aspirational in some respects.

WHAT’S CHANGED?

At a high level, an organizing theme of ILPA 3.0 is ILPA’s concern for misalignment between the interests of GPs and LPs borne out of a rapidly evolving industry that has seen record-levels of fundraising and distributions since 2011 when ILPA 2.0 was published. ILPA 3.0 expands on some of the recommendations set out in ILPA 2.0 in areas such as fund economics, fiduciary duties, key person provisions and best practices for limited partner advisory committees (“LPACs”). The principles are also heavily focussed on transparency and adequate reporting by GPs. While many of ILPA’s recommendations are relatively uncontroversial, other recommendations may be more troubling for fund sponsors, specifically those that would impact the economics of a fund:

Calculation of Preferred Return. ILPA recommends

>> Continued on Page 7
Hello Friends,

I am excited to see many of you in Washington in early September. As you will see in this edition of Preferred Returns, we have two full days of excellent content planned. Among other things, we have five speakers at our main Committee meeting touching on a wide variety of issues; two sponsored and five co-sponsored CLEs through which you can earn up to 13 CLE credits; and nine subcommittee meetings. In addition, we have what promises to be a terrific dinner at the Hotel Monaco, sponsored by Houlihan Lokey and Carta. Rob Rosenberg and Younna Salameh of Houlihan Lokey, and Reed McBride, Tim Gunderson and Michael Mozer of Carta, will be at our meeting in person. Please join me in thanking them for their support of our Committee.

This note is the last I write as Chairperson of our Committee. I am pleased to announce that Steve Wilson of Osborne Clarke and Josh Geffon of Stradling will be co-Chairs of our Committee going forward.

Our Committee was founded by Bruce Mann of Morrison & Foerster. Led by subsequent chairs Chip Lion (Morrison & Foerster), Samantha Horn (Stikeman Elliott), Mark Danzi (Mangrove Equity Partners), and Jon Gworek (Morse, Barnes-Brown & Pendleton), we have been expanding our membership and substantive offerings ever since. When I started my term in 2016, our Committee was a vibrant one, with a diverse and energetic membership, and an excellent group of leaders. I hope you agree that these past three years have seen our Committee continue along that path. During that time, with the hard work of our Committee members and leadership team, we have, among other things:

- Expanded our leadership ranks so that almost all of our Subcommittees now have co-chairs;
- Strengthened our ties with the Delaware judiciary, with each of Vice Chancellor Sam Glasscock and Justice Randy Holland serving terms as our judicial liaison and Vice Chancellor Kathaleen McCormick filling that role on a go-forward basis;
- Formed our Academic Subcommittee, which for each of the past three annual meetings has both held a substantive Subcommittee meeting and sponsored a standing-room-only CLE on Cutting-Edge Issues in Venture Capital and Private Equity, through which academics present papers and prominent practitioners comment;
- Continued our collaboration with other Committees through having the Private Equity M&A Subcommittee become a joint subcommittee of the Mergers and Acquisitions Committee and our Committee, and forming the Financial Services Technology Subcommittee with the Commercial Finance Committee and the Contractual Governance of Business Entities Joint Task Force with the Corporate Governance Committee and the Middle Market and Small Business Committee;
- Rebooted our Private Equity and Venture Capital Committee Dictionary Task Force with a goal of preparing our first stand-alone Committee publication;
- Reworked our in-person meeting schedule to start with a Welcome Breakfast for members to meet each other and Committee leadership, immediately followed by our main Committee meeting so that members can learn from the start what our Subcommittees and Task Forces have planned; and
- Increased attendance at our Committee dinner to what is now a record 100 tickets for the Washington meeting.

Most important to me over the past three years are the friendships I’ve formed with the incredible people who comprise both our membership and leadership. I have every expectation these are lifelong friendships, and I have this Committee to thank for that. Transitioning to Steve and Josh over the past couple of months, I know that they have a lot of exciting things planned, and I look forward to watching where they steer us over the course of their term.

Thank you again for the opportunity you gave me. It was an honor that is truly appreciated and an experience I will treasure for the rest of my career.

Best,

Eric

Klinger-Wilensky

Chair
Looking Ahead to Washington, D.C

> What the Committee Has in Store >> Continued on Page 4

### PRIVATE EQUITY AND VENTURE CAPITAL COMMITTEE MEETING

**Thursday Sept. 12, 2019**
(9:00 AM – 11:00 AM)

**Salon L, M4**

At our main Private Equity and Venture Capital Committee Meeting we will be hearing from both of our generous sponsors, Houlihan Lokey who will provide us with a PE and VC market update, and Carta who will discuss traditional mistakes attorneys make on cap table management. In addition, Andrew Herman (Gibson, Dunn & Crutcher) will provide commentary on privilege issues when dealing with designees to a portfolio company board, and Brian Huber (Gunderson Dettmer) will discuss regulations, including CFIUS, and how they impact fund work and drafting.

- **Toll-free dial-in number (U.S. and Canada):** (866) 646-6488
- **International dial-in number:** (707) 287-9583
- **Conference code:** 9241077311

### ACADEMIC SUBCOMMITTEE MEETING

**Thursday Sept. 12, 2019**
(11:00 AM – 12:00 PM)

**Salon I, M4**

Please join Jill Fisch (Penn Law) as she presents a working project on Appraisal Waiver. A group discussion on the topic in private VC/PE firms and more broadly, will also take place.

- **Toll-free dial-in number (U.S. and Canada):** (866) 646-6488
- **International dial-in number:** (707) 287-9583
- **Conference code:** 7227876294

### ANGEL FINANCING CAPITAL SUBCOMMITTEE MEETING

**Thursday Sept. 12, 2019**
(1:30 PM – 2:30 PM)

**Salon I, M4**

Matt Kittay (Fox Rothschild) and Tim Poydenis (Cooley) will lead a discussion on Corporate Transactions with Small Businesses focusing on certain key considerations for early-stage companies that depend on revenue from federal government contracts awarded only to “small business” and understanding how equity financing and other customary corporate events may impact continued eligibility for such “small business” status.

- **Toll-free dial-in number (U.S. and Canada):** (866) 646-6488
- **International dial-in number:** (707) 287-9583
- **Conference code:** 7227876294

### FINANCIAL SERVICES TECHNOLOGY JOINT SUBCOMMITTEE MEETING

**Thursday Sept. 12, 2019**
(4:30 PM – 5:30 PM)

**Chinatown, M3**

Jonathan Cardenas (Crowell & Moring) will moderate a panel on ‘Venture Capital Investment in Latin American Fintech’. The panel will discuss legal, financial and regulatory issues surrounding seed capital and venture capital financing of Fintech startups in Latin America. Panelists will include Bruno Balduccini (Pinheiro Neto Advogados), Diego Herrera (Inter—American Development Bank), Gabriel Matarasso (Marval, O'Farrell, & Maira), and Luis A. Nicolau (Ritch, Mueller, Heather y Nicolau).

- **Toll-free dial-in number (U.S. and Canada):** (866) 646-6488
- **International dial-in number:** (707) 287-9583
- **Conference code:** 7227876294

### PRIVATE EQUITY AND VENTURE CAPITAL FUNDS SUBCOMMITTEE MEETING

**Thursday Sept. 12, 2019**
(4:30 PM – 5:30 PM)

**Salon I, M4**

John Crisp (Sheppard Mullin) will be leading a discussion via GotoMeeting on “New Regulations related to Qualified Opportunity Zone Funds”. Please join the program by logging on to GotoMeeting from your computer, tablet or smartphone at https://global.gotomeeting.com/join/282150309 or telephone dial-in:

- **United States:** +1 (872) 240-3212
- **Access Code:** 282-150-309

- **Toll-free dial-in number (U.S. and Canada):** (866) 646-6488
- **International dial-in number:** (707) 287-9583
- **Conference code:** 7227876294

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PAGES 19-21

BEST OF WASHINGTON, D.C
The Task Force will continue its work on a book focused on the Top 10 issues in governance of contractual business entities. Anyone interested in participating is invited to attend.

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 4961649712

**Scott Bleier (Morse)** will be moderating a discussion with Nevena Simidjiyska (Fox Rothschild) regarding “Expansion of Foreign Investment Scrutiny and Venture Investing.” The discussion will focus on a series of hypotheticals to help the audience understand the CFIUS regulatory framework in connection with foreign investment into US businesses and offer practical solutions for practitioners when they advise clients.

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 3345188240

Please join Gesta Abols (Fasken) at the kickoff meeting for the rebooted Private Equity and Venture Capital Dictionary Task Force. If you are looking for an opportunity to become involved in an ABA project from the ground up, this is your chance!

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 4122565797

Scott Bleier (Morse) will be moderating a discussion with Nevena Simidjiyska (Fox Rothschild) regarding “Expansion of Foreign Investment Scrutiny and Venture Investing.” The discussion will focus on a series of hypotheticals to help the audience understand the CFIUS regulatory framework in connection with foreign investment into US businesses and offer practical solutions for practitioners when they advise clients.

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 3345188240

**The Private Equity M&A Joint Subcommittee will have two panel presentations. Sophie Lamonde (Stikeman Elliot) and Neal Reenan (Kirkland and Ellis) will discuss financing issues in Private Equity M&A transactions. Topics will include how a seller protects itself if a “newco” buyer that is party to a purchase agreement fails to close. Jeny Maier (Azinn, Veltrop & Harkrider) and John Clifford (McMillan) will discuss Antitrust Issues for Private Equity M&A Lawyers. Topics will include issues regarding the pooling of bids by private equity firms and strategies for handling HSR Act requirements.**

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 5213674877

The Subcommittee will be reviewing “Hot Topics in Private Equity and Venture Capital”, with a discussion of recent cases imposing fiduciary obligations on private equity investors and best practices for investors and their director designees to avoid liability as fiduciaries. The panel also will address what obligations, if any, board observers owe portfolio companies and their stockholders in light of the recent Third Circuit decision in the Obasi matter. Subcommittee Chairs, Tom Mullen (Potter Anderson Corroon) and Lisa Stark (K&L Gates), will moderate the discussion with Jacqueline Brooks (Saul Ewing Arnstein &Lehr); Lisa Hendrick (Hirschler Fleischer) and Pamela Millard (Potter Anderson Corroon).

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 3345188240

**Jonathan Cardenas (Crowell & Moring) will moderate a panel on “Cross-Border Private Equity Transactions in the Fintech Sector: A Close Look at Fintech Growth Equity and Leveraged Buyout Transactions.” The program will provide an overview of legal and financial issues that arise in the cross-border private equity fintech transactional context, including transactional due diligence and regulatory issues that affect Fintech growth equity and leveraged buyout transactions, as well as obstacles that can affect these transactions in a cross-border setting. Panelists include William McIntosh (Brodies Solicitors), Hassan Sobhi (Taylor Wessing LLP), Bruce Stephen (Brodies Solicitors), and Piero Venturini (Legance Avvocati Associati). In addition, please join us for a review the Atlassian Acquisition Term Sheet: The tech unicorn published its acquisition term sheet, which sets out its preferred terms – aimed at improving on standard deal norms. A panel of international lawyers including Katrien Vorlat (Monard Law) and William McIntosh (Brodies Solicitors) will comment on this from different jurisdictional angles.**

**Toll-free dial-in number (U.S. and Canada):** (866) 646-6488  
**International dial-in number:** (707) 287-9583  
**Conference code:** 3345188240
Perspectives on Cutting-Edge Issues in Venture Capital and Private Equity
Thursday Sept. 12, 2019 | 2:30 PM - 4:30 PM EST | Salon 8, M2

Brian Broughman (Indiana University Maurer School of Law) will be moderating a discussion on the following academic papers:

“Startup Governance” written by Elizabeth Pollman (Loyola Law School, Los Angeles). Jeff Wolters (Morris, Nichols, Arsh & Tunnell) will be providing commentary.

“The Private Equity Negotiation Myth” written by William W. Clayton (BYU J. Reuben Clark Law School). Robin Painter (Proskauer Rose) will be providing commentary.

“The New Unicorn Investors – Disruptors or Distractors?” written by Anat Alon-Beck (Case Western Reserve University School of Law). Sam Angus (Fenwick & West) will be providing commentary.

“Variance Seeking VCs” written by Jesse M. Fried (Harvard Law School). Danny Aronson (Berger Singerman) will be providing commentary.

Staying Private Longer: Why Go Public While There are So Many PE/VC Investors?
Friday Sept. 13, 2019 | 8:00 AM - 10:00 AM EST | Salon 3, M2

Despite the fact that an IPO has historically been viewed as the crowning achievement for a private company, companies are staying private longer than they have in the past. This trend can be attributed to a number of factors, including the growing supply of private capital, the introduction of more rigid securities regulations, the high cost of public markets, as well as inherent market risks.

The presentation will discuss why, in certain circumstances, it has become more feasible for private companies to stay private. Private companies are now equipped with many of the same capabilities and resources as public companies.

CLE panelists include:

Elliot Greenstone (Davies Ward Phillips & Vineberg)
Stephen Glover (Gibson, Dunn & Crutcher)
Michael Labriola (Wilson Sonsini Goodrich and Rosati)
Niki Fang (Orrick Herrington & Sutcliffe)
Eric Bowers (Sonos)

AND CO-SPONSORING 5 MORE!

Operating Agreements from the Minority Perspective: Rosencrantz & Guildenstern are Dead
Presented by LLCs, Partnerships & Unincorporated Entities | Thursday Sept. 12th, 2019 | 8:00 AM - 10:00 AM EST | Salon 3, M2

10 Things Corporate Lawyers Must Understand about How an LLC is NOT a Corporation
Presented by LLCs, Partnerships & Unincorporated Entities | Thursday Sept. 12th, 2019 | 2:00 PM - 3:30 PM EST | Salon 1, M2

Coming to America – European M&A Deal Terms are Increasingly Found in U.S. Deals
Presented by the Middle Market and Small Business Committee | Thursday Sept. 12th, 2019 | 3:00 PM -4:30 PM EST | Salon 9, M2

How to Maximize the Value and Reduce the Cost of Corporate Legal Services
Presented by Corporate Counsel Committee | Friday Sept. 13th, 2019 | 10:30 AM - 12:30 PM EST | Salon 2, M2

The Anatomy of Private Equity Investment in Health Care Services
Presented by Health Law & Life Sciences Committee | Friday Sept. 13th, 2019 | 10:30 AM - 12:30 PM EST | Salon 3, M2
### Schedule of Events

#### Thursday September 12, 2019

<table>
<thead>
<tr>
<th>Event</th>
<th>Location / Dial-in Code</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Equity and Venture Capital Welcome Breakfast</td>
<td>Salon L, M4</td>
<td>8:00 AM - 9:00 AM EST</td>
</tr>
<tr>
<td><strong>Co-Sponsored CLE Program:</strong> Operating Agreements from the Minority Perspective: Rosencrantz and Guildenstern are Dead</td>
<td>Salon 3, M2</td>
<td>8:00 AM - 10:00 AM EST</td>
</tr>
<tr>
<td><strong>Main Committee Meeting of the Private Equity and Venture Capital Committee</strong></td>
<td>Salon L, M4 Dial-in Conference Code: 9241077311</td>
<td>9:00 AM - 11:00 AM EST</td>
</tr>
<tr>
<td><strong>Academic Subcommittee Meeting</strong></td>
<td>Salon I, M4 Dial-in Conference Code: 7227876294</td>
<td>11:00 AM - 12:00 PM EST</td>
</tr>
<tr>
<td><strong>Angel Financing Subcommittee Meeting</strong></td>
<td>Salon I, M4 Dial-in Conference Code: 7227876294</td>
<td>1:30 PM - 2:30 PM EST</td>
</tr>
<tr>
<td><strong>Co-Sponsored CLE Program:</strong> 10 Things Corporate Lawyers Must Understand about How an LLC is NOT a Corporation</td>
<td>Salon 1, M2</td>
<td>2:00 PM - 3:30 PM EST</td>
</tr>
<tr>
<td><strong>Sponsored CLE Program:</strong> Perspectives on Cutting-Edge Issues in Venture Capital and Private Equity</td>
<td>Salon 8, M2</td>
<td>2:30 PM - 4:30 PM EST</td>
</tr>
<tr>
<td><strong>Co-Sponsored CLE Program:</strong> Coming to America – European M&amp;A Deal Terms are Increasingly Found in U.S. Deals</td>
<td>Salon 9, M2</td>
<td>3:00 PM - 4:30 PM EST</td>
</tr>
<tr>
<td><strong>Financial Services Technology Joint Subcommittee Meeting Private Equity and Venture Capital Committees</strong></td>
<td>Chinatown, M3 Dial-in Conference Code: 1145265056</td>
<td>4:30 PM - 5:30 PM EST</td>
</tr>
<tr>
<td><strong>Private Equity and Venture Capital Funds Subcommittee Meeting</strong></td>
<td>Salon L, M4 Dial-in Conference Code: 7227876294</td>
<td>4:30 PM - 5:30 PM EST</td>
</tr>
<tr>
<td><strong>Private Equity and Venture Capital Committee Dinner</strong></td>
<td>Kimpton Hotel Monaco</td>
<td>7:30 PM - 10:00 PM EST</td>
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#### Friday, September 13, 2019

<table>
<thead>
<tr>
<th>Event</th>
<th>Location / Dial-in Code</th>
<th>Time</th>
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<tbody>
<tr>
<td><strong>Sponsored CLE Program:</strong> Staying Private Longer: Why Go Public While there are So Many PE/VC Investors?</td>
<td>Salon 3, M2</td>
<td>8:00 AM - 10:00 AM EST</td>
</tr>
<tr>
<td><strong>Contractual Governance of Business Entities Joint Task Force Meeting</strong></td>
<td>Honeysuckle, 2nd Floor Dial-in Conference Code: 4961649712</td>
<td>9:00 AM - 10:00 AM EST</td>
</tr>
<tr>
<td><strong>Private Equity M&amp;A Joint Subcommittee Meeting of the Mergers and Acquisitions and Private Equity and Venture Capital Committees</strong></td>
<td>Salon 6, M2 Dial-in Conference Code: 5213674877</td>
<td>10:30 AM - 12:00 PM EST</td>
</tr>
<tr>
<td><strong>Co-Sponsored CLE Program:</strong> How to Maximize the Value and Reduce the Cost of Corporate Legal Services</td>
<td>Salon 2, M2</td>
<td>10:30 AM - 12:30 PM EST</td>
</tr>
<tr>
<td><strong>Co-Sponsored CLE Program:</strong> The Anatomy of Private Equity Investment in Health Care Services</td>
<td>Salon 3, M2</td>
<td>10:30 AM - 12:30 PM EST</td>
</tr>
<tr>
<td><strong>Private Equity and Venture Capital Dictionary Task Force Meeting</strong></td>
<td>Scarlet Oak, 2nd Floor Dial-in Conference Code: 4122565797</td>
<td>1:30 PM - 2:30 PM EST</td>
</tr>
<tr>
<td><strong>Venture Capital Financing Subcommittee</strong></td>
<td>Union Station, M3 Dial-in Conference Code: 3345188240</td>
<td>2:30 PM - 3:30 PM EST</td>
</tr>
<tr>
<td><strong>Private Equity and Venture Capital Jurisprudence Subcommittee Meeting</strong></td>
<td>Union Station, M3 Dial-in Conference Code: 3345188240</td>
<td>3:30 PM - 4:30 PM EST</td>
</tr>
<tr>
<td><strong>International VC &amp; PE Subcommittee Meeting</strong></td>
<td>Union Station, M3 Dial-in Conference Code: 3345188240</td>
<td>4:30 PM - 5:30 PM EST</td>
</tr>
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1. **Note:** CLE Programs are not accessible by Dial-in.
uses of those subscription lines in the fund’s partnership agreement or consider adopting the ILPA guidance from 2017.

Clawback. ILPA has reverted to its 2009 position regarding the calculation of clawback obligations: any clawback obligation should be determined gross of taxes paid by carried interest recipients. This approach would have the effect of individual carry recipients being out of pocket for taxes paid on the carried interest, which may not be recoverable following a clawback payment.

Fee Offsets. ILPA 3.0 states that “[a]ny portfolio company fees that are charged should be 100% offset against the management fee and subject to standard disclosure.” (ILPA 3.0, pg. 13). ILPA’s prior view was simply that fee offsets should accrue to the benefit of the fund. While a 100% fee offset is quite typical, the devil is always in the details. For example, an issue that may arise relates to LPS such as the sponsor who do not pay management fees. Because those LPS do not pay management fees, they would not get a benefit of a fee offset if it is structured as a simple 100% offset. An alternative approach is to notionally allocate a pro rata portion of fee offsets to all LPS, including those who do not pay management fees, to avoid skewing the economics amongst the LPS as a result of the offset.

Partnership Expenses. There is an increased focus in ILPA 3.0 on the type of expenses that would be appropriate to charge to a fund. For example, an ILPA 3.0 compliant fund would be permitted to charge the costs of a third party administrator to the fund only if the LPS have approved the use of a third party administrator. In addition, travel expenses related to sourcing a deal, networking and “preliminary” due diligence should be borne by the fund manager, and not the fund itself. Under ILPA 3.0, travel related to a potential investment may be treated as a transaction cost borne by the fund only after the potential investment advances past the initial term sheet. ILPA also states that expenses for ESG-related due diligence, management and reporting should be borne by the manager.

In addition to the recommendations relating to economic terms, ILPA 3.0 includes the following:

- GPs should consider establishing and maintaining an ESG policy with verifiable procedures and protocols;
- any and all changes in ownership of the fund manager, however small, should be reported to LPS in advance;
- fund sponsors should seek to “avoid over-concentration in short time periods” (ILPA 3.0, pg. 22) (although ILPA has not recommended including pacing requirements in the partnership agreement);
- all potential conflicts of interest, including those specifically contemplated in a fund’s governing agreements, should be cleared by the LPAC. ILPA has identified cross-fund investments and GP-led secondary transactions as of particular concern in this regard;
- carve-outs to indemnification clauses such as fraud, gross negligence and willful misconduct should not be qualified by material adverse effect: “GPs should not acquiesce to counsel recommendations to lessen the fiduciary duty owed LPS” (ILPA 3.0, pg. 21); and
- indemnification expenses should be “capped as a percentage of total fund size” (ILPA 3.0, pg. 21).

HOW ILPA 3.0 WILL CHANGE YOUR LIFE, OR WILL IT?

It would be easy to conclude that ILPA 3.0 will change the landscape of fund term negotiations in a significant way given the extent of the recommendations in ILPA 3.0. But in the immortal words of Doc in Back to the Future Part III, “your future hasn’t been written yet. No one’s has. Your future is whatever you make it.” Market practice varies from ILPA’s past recommendations, and it is likely to continue to do so in the future. In my view, the best response to ILPA 3.0 would be reasoned, contextual and market-driven. After all, ILPA itself acknowledged that the principles should not be applied as a checklist, as each partnership should be considered separately and holistically. A single set of preferred terms and practices cannot provide for the broad variability of products, strategies and investor preferences across the market at any given time, nor account for every individual circumstance.” (ILPA 3.0, pg 6).

If you are acting on behalf of a private equity fund sponsor, you would be well-advised to become familiar with ILPA 3.0, and you should come to the negotiating table prepared to discuss why your client has proposed certain fund terms that diverge from ILPA 3.0. Conversely, if you are acting on behalf of an investor, you should consider ILPA 3.0 in the context of each fund you are evaluating, the parties’ relative bargaining powers and your client’s priorities. ILPA 3.0 has not relieved us of the obligation to pick our battles, but it has given us more things to think about when we do.

Endnotes
1 “ILPA Principles”, available at https://ilpa.org/ilpa-principles-3-0.
2 Id.
5 https://www.imdb.com/title/tt0090642/characters/person3182072
A
fter a record high of $22 billion in secondar
dy deals lead by financial sponsors in 2018, 2019 is anticipat-
ed to be another record year for the secondary market. Secondaries
have been on the rise for several years now.1
The general partner (GP)-led processes to restructure fund portfolios are not only
becoming more commonly accepted and continuing to attract at-
tention by stakeholders in the private equity industry;2 they are also
growing in scope and in scale.3
Secondary investors seek to invest in managers that will use their investment for endeavors accre
tive to the value of the management company. Consequently, GP-led secondary transactions
primarily stem out of GPs requiring addi-
tional commitments to launch new initiatives in new sectors and ge-
ographies, to increase a fund’s commitments and to seed new strat-
egies.4
The most common transaction structures for GP-led secondary transactions fall into the following catego-
ries:

» **Secondaries Directs**, where the GP sells any remaining portfolio assets to a secondary investor;

» **GP-Led Tender Offers**, where the GP tenders all or a portion of the existing limited partners (LPs) interests to a secondary investor;

» **GP-Led Restructurings or Fund Recapitalisations**, where the GP establishes a new vehicle, that it will manage and in which a secondary investor will invest, and transfers all or a portion of the portfolio assets of the existing fund to such new vehicle, with existing LPs having the option to redeem out of the existing fund or to roll over their interests in the new vehicle;

» **Stapled Secondaries**, where the GP structures a hybrid transaction composed of a primary offering in the existing fund and either a restructuring or a tender offer, and offers the existing LPs to either (i) increase their commitment in the existing fund (with

"Continued on Page 9"
GP-led secondaries have proven to be an excellent way to provide liquidity for LPs and to maximize the value of fund’s assets by extending the term of the fund. Nevertheless, GPs should carefully consider potential issues that may arise in order to avoid unsuccessful transactions. Notably, GPs should be mindful of any existing stakeholder rights, any tax consequences of the proposed transaction and of potential conflicts of interests that may arise.

GP-led secondaries are especially ripe with conflicts of interest that will need to be managed by GPs, in most cases, in concert with the LPs and secondary investors. As the GPs are generally involved on both sides of the transaction, their interests may come into conflict, or may be perceived to come into conflict, with that of the LPs. In the case of Secondary Directs, a GP’s interest as the recipient of carried-interest may come into conflict with the interest of LPs. In the case of GP-Led Tender Offers, GP-Led Restructurings or Stapled Secondaries, the fact that the GP will continue to be involved in the management of the assets adds an additional layer of conflict to be considered by the GP and its LPs. In addition, conflicts of interests may exist between groups of LPs where one group wishes to rollover to the new vehicle and the other wishes to redeem.

In order to foster successful transactions, GPs should articulate a clear and compelling transaction rationale and address any conflict of interest early in the transaction process. In addition, GPs should show transparency, encourage communication, provide sufficient time for the parties to consider the issues, and, to the extent required, seek third party-input.

In light of the growing popularity of GP-led secondaries, the Institutional Limited Partners Association published Considerations for Limited and General Partners in April 2019, a guide that GPs can consider when contemplating these transactions. This guide can be a useful checklist of items GPs should consider and discuss when planning a GP-led secondary. Focused on encouraging successful, transparent and efficient GP-led secondaries, the guide notably provides that:

1. GPs must engage and inform the LPs and the Limited Partner’s Advisory Committee (LPAC) as soon as possible in the process and seek to provide them with as much information as possible.

GPs should endeavor to achieve parity in the information provided to the secondary investor, to the LPAC and to existing LPs. ILPA points out that GPs should provide:

- sufficient information for the LPs and LPAC to be able to assess whether the GP-led process was appropriate to secure a fair price (disclose: number, range and content of bids received);
- a detailed overview of how the economics between the GP and the secondary investor will be structured;
- a summary of any impact of the transaction for the LPs (disclose: management fees and carried interest amount for LPs in the continuing fund or in the existing fund and any significant changes in the terms of the fund);
- adequate disclosure on potential conflicts of interests (disclose: detailed information relating to the conflict and whether any LPAC member is participating in the transaction as an acquirer).

2. GPs should establish a fair process that provides all stakeholders adequate time and resources to make an informed decision.

In the establishment of the process, the GP should, on the one hand, seek to comply with the limited partnership agreement. Terms such as conflict of interest approval protocols, voting processes and valuation procedures, notice periods, expense allocation, including broken deals, and required disclosures should be taken into consideration. On the other hand, GPs should also consider involving any other stakeholders early on in the process. GPs should consider whether LPs have institutional requirements, such as ERISA, whether there are any other stakeholders such as management teams, co-investors and lenders.

In establishing the timeline, ILPA recommends that LPs be given no less than 30 days (or 20 business days) to consider the proposal before making a decision.

3. Parties should consider whether third party advisers should be appointed.

ILPA recommends that:

- GPs appoint and experienced advisers to solicit bids;
- The LPAC review the GPs selection of the adviser and have access to the adviser throughout the solicitation process;
- The LPAC consider engaging an independent legal and specialist adviser;
- In certain circumstances, the LPs obtain an independent assessment of the value of the portfolio, together with a fairness opinion.

Endnotes
3 Lazard, supra note 1 at p. 3.
5 ILPA, supra note 2 at p. 3.
6 We have not sought to summarize all recommendations set out in the ILPA publication, supra note 2.
Private Equity Investing in the UK – BREXIT – THREAT OR OPPORTUNITY?

“It was the best of times it was the worst of times....”
- the immortal opening lines of Charles Dickens’ 1859 novel, a Tale of Two Cities, might reasonably be used to describe the current investment environment in the UK and, to a lesser extent, the rest of Europe.

Having been around at the time of, and having survived, the last two recessions and the financial crisis of 2008-2010, I am a great believer that change is generally good for the private equity sector. When things change, businesses have to do something: standing still and doing nothing is rarely a viable option if you want to survive or, better still, take advantage of the opportunities that change presents. Such an environment creates opportunity for private equity.

In the UK, having voted to leave the European Union on 23 June 2016, the deadline to do so of 31 October 2019 is rapidly approaching with no clear indication, at the time of writing, of what this will mean for the UK or for Europe. Boris Johnson, the new UK Prime Minister, has taken a much harder, some might say Trumpesque, stance to the Brexit negotiations than his predecessor, Teresa May, and currently the spectre of a no-deal Brexit looms large.

The evidence on the impact of Brexit on foreign direct investment (“FDI”) into the UK continues to be mixed, with the natural volatility of FDI inflows making extraction of a clear “Brexit effect” from the data difficult. A UK parliamentary briefing on FDI into the UK published in March this year found that the pace of FDI continued to grow after the EU referendum result but the rate of growth is slowing.

Brexit appears to be weighing more heavily on investors as the UK’s exit from the EU approaches. EY’s European Attractiveness Survey, published in June 2019, found Brexit to be the most significant risk to Europe’s attractiveness, up from fourth last year. The Financial Times reported in the same month that 15% of global investors said they had paused a project in the UK as a result of Brexit, almost double the amount from the previous year.

At present it is not clear whether any Brexit effect is a temporary response to the uncertainty over the future UK/EU relationship, or represents a permanent change in the landscape – another UK Parliament briefing into the economic effect of Brexit noted that, far from the UK being reliant on “the EU single market and customs union” as its principal attraction for overseas investment, “the UK has flexible labour markets, a language spoken widely around the world, an educated workforce and a strong rule of law which are attractive for investors.”

After a period of “behind the scenes” preparation for a no-deal Brexit, the UK government is now openly working hard to prepare for a hard Brexit, making sure that viable contingency plans are in place. Import procedures are being simplified, transitional rules (at least our side of the English Channel) are emerging and stand-alone trade deals are being discussed.

What difference does that make to me? I hear you ask.

The fact is the UK is an attractive environment to invest in right now with UK companies looking undervalued compared to their global comparators. Added to this, with historically low exchange rates (and with increased speculation that the pound could possibly fall a further 10% against the dollar) the US dollar goes much further in Europe than ever before and, although competition for the best assets is strong, it feels less competitive than the US. From our own experience, we have continued to see high levels of inbound M&A activity throughout 2019, particularly from the North American continent.

Anecdotally I have spoken with a number of US PE investors looking to invest in Europe recently and it is not uncommon to be told that, whilst in Europe they may find themselves competing with 10 or so other financial sponsors, in the US for the best assets, the number of competitors can easily reach 50 or 60 competing funds, meaning they have to be much more selective about which processes they participate in.

Political concerns around the extent of overseas control of strategically important businesses, infrastructure and technology have led to a number of proposals for the tightening of FDI controls at both EU and national level in recent months.

The global trend is towards greater scrutiny of foreign investments. For example, the UK government has recently consulted on a new UK national security review regime. Under the reforms, the government would have the power to “call in” transactions for review where a “trigger event” (broadly speaking, the acquisition of a significant stake or other position of significant influence or control over a sensitive entity or asset) gives rise to a reasonable suspicion of a national security risk. A notification system is proposed so that trigger events could be voluntarily notified by parties and pre-cleared. The government expects around 50 deals per year to be subject to possible intervention. In comparison, over the last two years there has only been one national security-related review per year and so the new rules would represent a step change in deal intervention by the UK government. In 2018 there were 22 deals blocked globally on the grounds of national security.

This is illustrated by the UK competition watchdog’s recent extension of the review deadline for the Apax led consortium’s $3.4 billion bid to take over Inmarsat, the UK’s leading global mobile satellite communications company. Whilst the initial review was sparked by anti-trust concerns, a second review has also been launched on the grounds of national security.

In June, in the UK alone, there were over

>> Continued on Page 11
$10 billion worth of private equity deals announced across a number of sectors making it by far the busiest month for PE activity this year. This follows a comparatively quiet first five months as financial sponsors struggled to quantify the long-term impacts of Brexit and currency swings when assessing potential acquisitions. Many now believe that investors have priced Brexit related risks into their bids and are bracing themselves to hold onto assets for longer.

At Osborne Clarke we are starting to see, and be approached by, North American mid-market PE funds looking, not only to co-invest alongside their European counterparts, but also to invest direct into European deals. For the most part they are looking outside their home market for “best of breed” businesses and business models that they can bring back to the US (which remains the biggest single national market globally).

Invariably to make the grade the European asset will already have an important (and growing) US aspect to its business, or will have a published strategy to grow in North America. In both cases the US PE house sees itself as having a compelling USP when compared to their European competitors, being on the ground, in time zone, and with the local knowledge and presence to really assist and support such US growth/expansion thus differentiating themselves in a way other than by paying the highest price!

Going forward, the sale of non-core assets, and carve outs of divisions of listed companies, is also likely to prove a fruitful feeding ground and source of high quality investment opportunities with increased levels of activist investor agitation encouraging PLC boards to unlock value and return it to shareholders. Private ownership ordinarily allows investors to take a longer term view than the public markets which are typically more affected, in the short term at least, by the macro economic environment.

Another potential opportunity for US mid-market financial sponsors, in order to avoid the current high pricing in the UK, with the seemingly never ending procession of investors deploying greater and greater amounts of capital into a smaller number of bigger deals, is to deploy capital in stages through proactive buy and build strategies in sectors ripe for consolidation. Whilst a number of buy out houses have successfully delivered on a buy and build strategy for a number of years, with the increased competition for, and pricing of, the bigger deals, we are seeing an increase in the number of funds that will invest a smaller amount than they would ideally like in an initial platform acquisition, and then deploy increasing amounts of capital through that vehicle by making a number of bolt on acquisitions, almost always at lower entry multiples than are likely to be archived on exit, providing a degree of PE arbitrage on every acquisition.

By way of example, we are currently working with one sponsor client on a buy and build strategy which entails completing 10 or 12 bolt on acquisitions (all of which had been identified prior to investment) in the first 12 months following completion of the initial platform deal.

Mark Spinner
Partner, Osborne Clarke LLP
SHOULD WE ASK VAN HELSING TO HELP WITH THE PRIVATE EQUITY VAMPIRE?

"[W]e ... will not be given over to monsters. We shall travel towards the sunrise; and, ... if we fall, we fall in a good cause."

Van Helsing, Dracula (ch. XXIV)

Bram Stoker's book, Dracula, introduces us to Professor Abraham Van Helsing, the most famous vampire slayer in literature and film. Should we ask Van Helsing to help with private equity (“PE”) firms? Why? Because PE firms are “vampires,” according to U.S. Senator Elizabeth Warren and others. Senator Warren says PE firms “suck millions of dollars from its victims through management fees and other payments. When these cash-poor companies careen into bankruptcy, the argument goes, PE walks away enriched and leaves the company dry and walking away enriched even as the company succumbs.”

Critics allege PE firms suck millions of dollars from its victims through management fees and other payments. When these cash-poor companies careen into bankruptcy, the argument goes, PE walks away enriched and leaves the company dry and walking away enriched even as the company succumbs.”

To remedy this vampire behavior, Senator Warren did not propose using the stake or the crucifix (Van Helsing’s preferred tools). Rather, in the proposed “Stop Wall Street Looting Act” (the “Looting Act”), she and her co-sponsors propose exposing certain PE groups to unlimited liability (in addition to other proposed remedies).

In this paper, we address the issues of limited and unlimited liability and then specifically apply the Looting Act’s remedy of unlimited liability to the Toys-R-Us bankruptcy, which is the critics’ favorite poster-child for PE “abuses.” (Conflict alert: several of my partners represented Toys-R-Us in its bankruptcy.) We conclude that the unlimited liability remedy would not have saved Toys-R-Us, and the jobs probably would have been lost in any event. We do not address the Looting Act’s other proposed remedies.

To assure PE has “skin in the game,” the Looting Act proposes that PE firms “share responsibility for the liabilities of companies under their control including debt, legal judgments and pension-related obligations ...” (collectively, “Liabilities”).4 Technically, this “shared responsibility” comes in the form of the legal doctrine of joint and several liability. Under the proposed Looting Act, if a PE firm invests $100 in a portfolio company it controls, and the company’s Liabilities exceed $100, the PE firm will be responsible for the company’s entire Liabilities. This is a radical proposal. It upends two centuries of the limited liability legal doctrine holding an investor (absent extraordinary circumstances) liable only for the amount of her investment – nothing more. Applying unlimited liability to this vital segment of the investment community would alter the private investment landscape materially and adversely.

Prior to imposing unlimited liability on PE, we should be certain the social costs far exceed the social benefits.

What are the social benefits of providing limited liability for PE investment?

Limited liability is essential to our modern economy. The modern world is built, in large part, by equity finance protected by limited liability, according to The Economist.4 We disturb this framework at our peril.

Limited liability fosters a vibrant investment community, a critical source of capital available for business growth and job creation. Investment promotes innovation, robust competition and excellence in the production of goods and services. This is not investment for investment’s sake, though: investment allows men and women to flourish in their jobs (eudaimonia, in the Greek). Human flourishing is one of the aims of a just society. As Martin Luther King, Jr. said: “All labor has dignity.”

Unlimited liability makes it impossible to weigh risk and reward, an essential part of investment decision making. The result would be catastrophic. Billions of dollars of investment would not be made if the PE firms were subject to unlimited liability.

PE is attracted by limited liability on its invested capital. Unlimited liability would have the opposite effect. The stakes are high. In my home state of Missouri, from 2013 to 2018, PE invested $47.71 billion.6 In 2018 alone, Texas, California and New York led all states, receiving an aggregate estimated $241 billion in PE investment.7

>> Continued on Page 13
The topic calls for more examination.

The social costs of providing limited liability on PE investment. Sufficient aggregate data on the social costs does not exist and academic studies are scant (but one is referred to the book, Private Equity at Work, and its comprehensive criticism of PE).

To focus on the issue, we discuss the Toys-R-Us bankruptcy as an example of “vampire capitalism,” according to numerous articles (including in The Atlantic and The Week). The critics argue PE bled Toys-R-Us, siphoning off millions in fees, resulting in the company’s liquidation and layoffs (without severance pay) for 30,000 workers. After public outcry, the PE firms in the Toys-R-Us bankruptcy did create a $20 million fund solely for company employees.

The Toys-R-Us facts. According to published reports, in 2005 three PE firms (Vornado Realty Trust, KKR and Bain Capital) purchased Toys-R-Us for $6.6 billion, with a combination of equity (roughly $1.3 billion) and debt from lenders (about $5.3 billion). These PE firms said they “invested a total of $3.5 billion back into Toys-R-Us during their ownership tenure,” but the “rise of Amazon and other online retailers ultimately crippled the business.” During that time, these PE firms received $470 million in management fees and interest payments.

The 2017 bankruptcy ended in Toys-R-Us’ liquidation, and the PE firms lost their full $1.3 billion equity investment. To be clear, they invested $1.3 billion in equity and received $470 million in fees, for a net loss of $830 million. Losing $830 million is not a sustainable investment strategy. One cannot invest billions (and only receive millions in return) and hope to remain in business for long. If the critics claim PE is enriching itself by “bleeding” its victims, the Toys-R-Us debacle is no example. With such an experience, if PE is a vampire, it will starve. Van Helsing is not needed.

Senator Warren’s proposal would have made things even worse. If the Looting Act was in effect with Toys-R-Us, the PE firms would also be jointly and severally for the entire Toys-R-Us debt ($5.3 billion) and for other liabilities (including, possibly, the $75 million severance pay due to workers). In other words, those firms would have been liable for about $5.4 billion in liabilities in a deal where they already lost $830 million.

The reality is, of course, that if the Looting Act had been in effect, the PE investment would never have been made in the first place. Those 30,000 workers probably would have lost their jobs a lot sooner than they did. And not because of PE. Why? The Toys-R-Us bankruptcy had a broader backdrop: internet sales fundamentally disrupted the brick-and-mortar retail sales model. Would Toys-R-Us have survived this disruption, absent the PE investment? If your answer is “yes,” consider this: Would you be happier standing in line at Toys-R-Us in the mall rather than ordering those toys online? The retail industry would have been disrupted by the internet even if no one had ever heard of PE.

Jobs follow investment. PE investment has been a significant job creator. There are about 85,000 jobs in Missouri PE-backed companies and millions more throughout the United States.

PE generates significant consistent net returns to its investors (especially pension funds), in general, besting all other asset classes over the past 25 years. According to Cambridge Associates (as of March 31, 2019), for the past 25 years, PE net returns to their investors exceed nine well-known U.S. public equity and bond indices (the only exception being for 10-year returns that include the Great Recession). For example, during the 20-year period ending March 31, 2019, the PE index showed a 12.01% net return compared to 7.5% for the Dow Jones Industrial Average and 5.89% for the Nasdaq Composite Index. Similar results obtain when one compares net PE returns to returns on other asset classes like real estate and commodities.

PE critics argue that it destroys more jobs than it creates. There is vigorous academic debate over this subject, with one group (led by Professor Stephen J. Davis) finding that, after considering new jobs lost, created or added, total employment at PE-backed firms increases (on average) by 13 percent over two years. Another group disputes this finding and attacks Professor Davis’s methodology.

The reality is, of course, that if the Looting Act had been in effect, the PE investment would never have been made in the first place. Those 30,000 workers probably would have lost their jobs a lot sooner than they did. And not because of PE. Why? The Toys-R-Us bankruptcy had a broader backdrop: internet sales fundamentally disrupted the brick-and-mortar retail sales model. Would Toys-R-Us have survived this disruption, absent the PE investment? If your answer is “yes,” consider this: Would you be happier standing in line at Toys-R-Us in the mall rather than ordering those toys online? The retail industry would have been disrupted by the internet even if no one had ever heard of PE.

Endnotes
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India has emerged as one of the most promising jurisdictions for deal making in South Asia. In 2018, private equity transactions in India were at an upward of US $33 billion in terms of value. The year also saw the emergence of new unicorn companies such as Policy Bazaar, Swiggy, Oyo, and Byjus, and it proved to be the year of exits too. The impressive exits that various private equity investors managed to get were the year of exits too. The impressive exits that various private equity investors managed to get were a further boost to their confidence in the Indian market economy. India is on the fast track to adopting global best practices: local fund managers have started operating with more sophistication; and their ongoing attempts to replicate the model that has worked in the West are apparent from the manner in which they have been adapting to the documentation and the overall style of their Limited Partners (“LP”).

**FUND STRUCTURES IN INDIA**

In India, funds are being structured as a ‘blind-pool’ model or a ‘deal-to-deal’ model. Such funds can also be structured as a hybrid model, which would have elements of both the aforementioned structures. In a blind-pool model, LPs rely on the expertise of General Partners (“GP”) to take investment decisions, whereas they themselves have only limited control over the deployment of the fund once they have committed the funds. The capital call and deployment of fund would proceed in the manner set out in the LP Subscription Agreement. In a deal-to-deal model, on the other hand, LPs have a stronger hold on the investment they have chosen.

In India, a fund may be registered as either an alternative investment fund (“AIF”) or a Foreign Venture Capital Investors (“FVCI”). An AIF does not give LPs much of a choice to veto a transaction: once the LP has consented to the investment thesis of the Indian fund at the time of executing the LP Subscription Agreement, the GP takes all the decisions pertaining to the investments with almost nil participation from the LP. On the other hand, FVCI can be structured in two different models: (i) the committed funds may be pooled in, or (ii) the fund manager may approach the LPs every time a new investment opportunity arises. This gives LPs more control over their decision on whether or not to participate in a new investment opportunity.

The key issue for an LP in the investment market is whether there is any way it can choose to opt out from a deal after the capital is committed. In a situation where the target company is present in a space that is fundamentally against the LP’s thesis or investment principles, the LP is concerned to ascertain whether it can instruct the fund not to deploy its capital in that opportunity. Globally, such situations are dealt with by introducing ‘Excuse Provisions’ in the LP Subscription Agreement.

**EXCUSE PROVISIONS**

An Excuse Provision enables an LP to refrain from participation in an investment opportunity that is identified by the GP. The ‘excuses’ may arise for various reasons such as (i) religious grounds, for instance, investments in firearms, meat, alcoholic beverages, etc.; (ii) LP’s legal inability to participate in the investment; and/or (iii) LP’s internal policy relating to, say, environment or social preservation. These provisions entail intense negotiation. The investors, in many instances, may try to retain the ability to cherry-pick deals by

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**LEGAL CONSIDERATIONS OF EXCUSE PROVISIONS IN INDIA**

Rangam Sharma  
J. Sagar Associates

Sajai Singh  
J. Sagar Associates

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Excuse Me!

**LEGAL CONSIDERATIONS OF EXCUSE PROVISIONS IN INDIA**

Rangam Sharma  
J. Sagar Associates

Sajai Singh  
J. Sagar Associates

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**LEGAL CONSIDERATIONS OF EXCUSE PROVISIONS IN INDIA**

Rangam Sharma  
J. Sagar Associates

Sajai Singh  
J. Sagar Associates

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way of Excuse Provisions whereas the GPs and fund managers attempt to narrow the scope of these provisions. Though the first preference of GPs and fund managers is to disallow any such reservations, yet the concerned parties often agree on an exhaustive list of such Excuse Provisions with no wriggle room for an alternate interpretation.

DRAFTING AN EXCUSE PROVISION IN THE INDIAN CONTEXT

Ideally, the LP Subscription Agreement should capture, in an unambiguous manner, the investments for which the GP has to take the LP's specific consent. While drafting the Excuse Provisions, the following features need to be borne in mind:

a. **Absolute prohibition.** The LP must provide an exhaustive list of the sectors that it does not intend to invest in. The language should be broad enough to cover these select sectors as also any activities that may indirectly relate to them.

b. **Disqualification of promoters.** In addition to the sectoral restrictions set out above, LPs have also, in the recent past, negotiated to include certain provisions that allow them to vet the promoters of the business that the fund is investing in. Many LPs may not want to invest in a business whose promoter has been charged or prosecuted for offences involving moral turpitude or who is being investigated by an enforcement authority.

c. **Jurisdiction.** Jurisdiction-related Excuse Provisions are also quite frequently seen in the LP documentation.

A key drafting point that the parties have to bear in mind is the inclusion of the clause ‘Most Favoured Investor’ (‘MFI’). Many LPs insist that the MFI clause is linked to the Excuse Provisions. In effect, all LPs with an MFI right may have the scope for augmenting the list of restrictive investments for the fund, which may become an added problem for the fund manager.

In order to mitigate the risk of capital crunch, GPs often demand the introduction of enabling language, stipulating that an anticipated contribution that remains unpaid by an excused LP be distributed proportionately among the other LPs. This, in effect, means that the latter are expected to make the contribution that was the responsibility of the excused LP. This proviso may find its place in a document that is heavily in favour of the GPs.

CHALLENGES IN ENFORCEMENT OF EXCUSE PROVISIONS

**Lack of statutory recognition**

The mechanics of an AIF in India is governed by SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”). AIF Regulations do not have any specific enforcement mechanism for Excuse Provisions. In the absence of any statutory recognition of such provisions, imposing the Excuse Provisions would depend primarily on whether they can be enforced contractually. In this regard, it should be noted that the LP may have to face various challenges. For instance, all reservations relating to the proposed investments have to be documented in the LP Subscription Agreement. Typically, once the documentation is frozen, no investment conditions can be altered easily. Consequently, if an LP intends to add additional reservations for investment, this may be challenging as that would require the fund manager’s/GP’s consent.

The situation is slightly different in the case of an Angel fund where the investor statutorily enjoys certain privileges. The AIF Regulations require the manager of the Angel Fund to obtain an undertaking from every Angel investor proposing to make investment in a venture capital undertaking, confirming their approval for such an investment, prior to entering into such an investment.

**Loss of high returns**

Funds attempt to diversify their risks by spreading their investments across high risk, medium risk, and low risk opportunities. When various LPs introduce their Excuse Provisions in the LP documents, the GPs may end up discarding many investments that may otherwise prove to be high return investments. It may be argued that the religious sentiment or some other restriction of one LP could deprive the entire fund and their other LPs of access to a high return investment and its benefits.

**Funds of Funds**

The inclusion of Excuse Provisions may become challenging for a fund of funds (“FoF”) where the LP is also a fund and is subject to restrictive Excuse Provisions of their LPs. An elaborate list of such provisions, which hinders the fund’s investment in various lucrative sectors, jurisdictions, etc., may prove to be a setback in the fund’s potential for making commercially sound investments. Further, the structuring and fund documentation could become cumbersome for an FoF in practice, as there are multi layers of LPs who may choose to include their restrictive covenants in the fund documentation.

THEREFORE ...

For a very long time in India, GPs tended not to force back the introduction of Excuse Provisions. As a result, the list kept growing elaborate, and soon the restrictions became the ‘market norm’ over a long period of time.

Now, increasing pressure on fund managers and GPs to provide their investors an exit at a desired valuation is changing the trend in the investment market. Given the performance in the last couple of years, GPs in India have no dearth of capital. Globally, investors have started seeing India as a hotbed for deal making and, as a result, the bargaining power of GPs has increased manifold. Consequently, only a limited list of items is currently being included under Excuse Provisions.

Finally, LPs must take cognizance of who their co-investors are and whether their investment thesis and restrictions may restrict the fund from investing in the opportunities that are in their own interest. Thus, it is recommend ed that all LPs conduct due diligence not only on the fund managers but also the co-LPs/co-investors. This will ensure that they do not invest in a fund where the ability to get exit is compromised by focusing on non-commercial considerations of co-investors/co-LPs.
**COMMITTEE HIGHLIGHTS**

**WELCOME BREAKFAST**

**What better way to kick off the Annual Meeting than with breakfast?**

Please join the Private Equity Venture Capital Committees at our welcome breakfast. Beginning at 8am on Thursday September 12, the Committee hosts a breakfast that leads up to the main Committee meeting at 9am. It’s a fabulous opportunity to meet the Committee’s leadership, mingle with other members, and fuel up before our main Committee meeting. We hope to see you there!

**A GREAT OPPORTUNITY TO GET MORE INVOLVED**

The Annual Meeting marks the official relaunch of the PE & VC Dictionary Task Force. Under the leadership of Gesta Ablos (Fasken) the taskforce will be holding its first meeting at 1:30 – 2:30 on Friday Sept. 13th, in Scarlet Oak, 2nd Floor. Please reach out to Gesta if you would like to participate, or simply show up to the meeting, it’s a fabulous opportunity to get more involved in our Committee.

**WE’RE ON SOCIAL MEDIA**

If you haven’t yet, please follow us on social media. It’s a great way to stay current on what the Committee is up to and what’s in store for upcoming meetings.

[linkedin.com/groups/2395267](https://www.linkedin.com/groups/2395267)

[facebook.com/ABABLSPEVC](https://www.facebook.com/ABABLSPEVC)

**INTRODUCING OUR NEW JUDICIAL LIAISON**

A warm welcome to our Committee’s new judicial liaison, Vice Chancellor Kathaleen McCormick. Vice Chancellor McCormick will unfortunately not be able to join us in D.C. but we look forward to meeting her at future meetings and to her involvement with the Committee. As well, a special thank you to her predecessor in the role, Justice Holland.

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**PRIVATE EQUITY M&A JOINT SUBCOMMITTEE**

**SEPTEMBER 13, 2019**

The Private Equity M&A Subcommittee last met on Friday, March 29 at 10:30 a.m. local time, in Vancouver, British Colombia, as part of the Business Law Section’s Spring Meeting. We had two presentations at our meeting. First, I was joined on a panel by Glen West of Weil Gotshal in Dallas, Texas and Jeffrey Katz of BDO in New York, New York for a discussion entitled “Drafting Proper Working Capital Dispute Resolution Provisions – What Can Be Learned from Penson Business Media Holdings.” The panel addressed the Penson Business Media Holdings decision, how the M&A Committee’s model agreements dealt with the issue and what happens when an accounting firm is asked to make legal decisions on how to run the process of resolving working capital disputes. On the second panel, Subcommittee Vice Chair Samantha Horn of Stikeman Elliot in Toronto, Ontario was joined by Elliot Greenstone of Davies Ward in Montreal, Quebec, and three Vancouver based panelists — Tracy McVicar of CAI, Maria Parella of Penderfund and Rob Wildeman of Jericho, to discuss the Vancouver and Canadian PE scene and cross border Private Equity into the U.S. The panel discussed industry focus, trends, the competitive landscape for deals and differences and similarities across the Canada/US border.

The Private Equity M&A Joint Subcommittee will meet again on Friday, September 13 at 10:30 a.m. local time in Washington, D.C., as part of the Business Law Section’s Annual Meeting. We have two panel discussions prepared. One panel, which will include Sophie Lamonde of Stikeman Elliot in Montreal, Quebeec, Neal Reenan of Kirkland and Ellis in Boston, Massachusetts, and I will discuss Financing Issues in Private Equity M&A Transactions. Topics will include how a seller protects itself if a “newco” buyer that is party to the purchase agreement fails to close. The second panel, which will consist of Jenny Maier of Axinn in Washington, D.C. and John Clifford of McMillan, Toronto, Ontario will discuss Antitrust Issues for Private Equity M&A Lawyers. Topics will include issues regarding the pooling of bids by private equity firms and strategies for handling HSR Act requirements. If time permits we may also discuss some recent developments.

My Vice Chairs (Mireille Fontaine of BLF in Montreal, Quebec and the aforementioned Samantha Horn) and I continue to seek YOUR feedback as to the meetings and the Joint Subcommittee, either by talking to one of us in Vancouver or reaching out to one of us afterwards. We are always looking for ideas for future programs, presentations and projects, as well as volunteers for all of them. And, as I’ve said before, if you don’t know me and you are at the Vancouver meeting, please feel free to come by and introduce yourself.

I look forward to seeing many of you in Washington on Friday, September 13th at 10:30 a.m. local time. If you are unable to be there, please feel free to dial in and listen using the instructions set forth elsewhere in Deal Points or Preferred Returns.

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David Albin
Chair, Finn Dixon & Herling LLP

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What documents or information should or should not be included in a Data Room?

What contracts must be signed before giving third parties access to a Data Room?

Here is a guide for when the target company is European, or processes data of European citizens.

In nearly all circumstances, documentation included in Data Rooms for the purposes of Private Equity (“PE”) investment, and other M&A transactions includes confidential, sensitive and/or personal information, sometimes irrelevant to the main purpose of the deal. The parties that share this information usually just sign an NDA without attending to other relevant matters of European Competition Law (although not always applicable) or European Data Protection Law (always applicable where personal data is included in the Data Room). However, this practice is not always correct.

In this article, we consider how European data protection obligations (and member state regulation) apply to due diligence in PE transactions, whether the acquiring or investing party is within or outside the European Economic Area.

Up to a few years ago, Data Rooms used to be physical rooms that safely kept the original documents (or copies) on physical paper and it was forbidden to remove them from the Data Room or make copies except in some exceptional cases. This practice relied on the fact that human memory of precise details (e.g. personal data) is limited. However, currently most Data Rooms are virtual, enabling massive and permanent electronic copying and increasing the risk of data breaches. Particular risks include a leak of the data to third parties or processing the data beyond the legal, technical or economic analysis required for Due Diligence and subsequent negotiations of representations and warranties.

In all cases, when the target is an EU company or the data otherwise includes EU citizen data, access to the Data Room must comply with European data protection rules, in particular obligations regarding lawfulness of processing and providing information to data subjects about the access and processing of their data by the potential buyer or investor.

Considering the European General Data Protection Regulation (GDPR) and as a national example, the new Spanish Data Protection Basic Law (LOPDGDD), the following recommendations should be considered:

1. **Remove personal data.** This involves a (usually manual) process of redacting documents to remove all traces of personal data to the extent this is possible, particularly when the analysis of the documents does not require the disclosure of any personal data. In many cases, this will not be possible or will be counterproductive as the names/identification of certain persons is required to carry out the Due Diligence (e.g. to check that certain authorised persons signed an agreement).

2. **Divide Data Rooms into two sections:** Data Rooms can be divided into sections according to the classification of the documents. For our purposes, we propose one section that contains documents with personal data (contracts, staff lists, staff tax certificates, etc.) and another that contains documents without personal data (accounts, etc.).

3. **Limit and monitor access:** Access to the section of the Data Room that includes documents with personal data should be limited, documented and monitored.

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in order to ensure that only authorized persons access this section. This should also ensure that no documents with personal data are removed or copied, and that the documentation is only analyzed for the limited purposes of the Due Diligence report and, where the deal goes through, to negotiate representations and warranties.

4 Interpose a third party between the target and the potential buyer: A conservative solution used in the past, that is still currently being used in some operations, is to interpose a consultant or lawyer between the target and the potential buyer so that this intermediary, although paid by the potential buyer, is subject to the contractual control of the target for data protection purposes. Under this contract the intermediary is considered a “data processor” (under past and current European data protection rules) under contractual and/or statutory obligations not to reveal any personal data to the potential buyer. This solution is also still used in Europe where the target must disclose some highly confidential technical information (for example, regarding patent applications, know-how, etc.) or other sensitive information that can affect the competitive position in the market (pricing, sourcing, etc.), using the intermediary to confirm the existence and general scope of information that cannot yet be shared or transferred from the target to the potential buyer.

5 Sign specific contracts regarding data protection: Under the European Data Protection Directive there were no express provisions for the communication of personal data from a target to a potential buyer and, where communication did not rely on a previously obtained informed consent of the data subject, it was not lawful. Accordingly, because in practice one could rarely find such prior informed consents from data subjects, the solution was to use an intermediary (as commented in paragraph 4 above), working under a Data Processing Agreement that considered the communication of data as a mere “access” to the data and the intermediary could only process the data to produce the Due Diligence report and eventually negotiate representations and warranties. In addition, the old Spanish privacy law (arts. 5 and 19, in combination with art. 27) considered that a communication of data had not taken place once the commercial operation was completed. However, with the new rules, we conceive the two following solutions:

- **More prudential and conservative solution:** consider that the buyer’s lawyers and auditors are “data processors”. In analogy to situations where highly confidential information has to be disclosed, e.g. in relation to patent applications or know-how, or to prevent competition law breaches while sharing information, a Data Processing Agreement should be signed between the target and a third-party intermediary (generally, a lawyer or consultant of the potential buyer) stating that the personal data in the Data Room cannot be disclosed to the potential buyer. This Data Processing Agreement needs to include all regulatory requirements set out in the GDPR (art. 28). Where the lawyer or consultant is a firm, each of its professionals should also sign a confidentiality and security form. This solution is convenient because under the Data Processing Agreement, the access to the personal data is lawful and data subjects need not be informed about the communication of their data to the intermediary.

- **More novel solution, but with certain risks and with the likely additional obligation to inform data subjects:** to rely on statutory provisions/exemptions. While the GDPR does not expressly contemplate whether the communication of personal data in a potential PE transaction implies an access or transfer of the data or is lawful, it does allow EU member states to make exceptions, which at least UK and Spain have done. For example, art. 21 of the new Spanish LOPDGDD states that: (i) such a communication is presumed lawful, provided that the processing of the personal data is necessary for achieving the operation and guarantees, where appropriate, continuity in the provision of services to data subjects; and (ii) personal data must be deleted if the transaction is not consummated. However, even if the access or processing is lawful under national law, the GDPR also requires this communication of personal data to be informed to data subjects (something that either or both parties in the transaction may not want to do), unless the parties can rely on any of the exceptions under art. 14.5 GDPR. Among these exceptions, art. 14.5(d) removes the obligation to inform where the party accessing the information is subject to a duty of professional secrecy imposed by the statutory rules at a European or Member State level. This is generally the case for European lawyers and doctors, but not for other professions or for companies and their shareholders. The other exceptions in art. 14 (e.g. impossible or disproportionate efforts) are not always applicable in the framework of a PE transaction. Therefore, these exceptions may have limited effect. In any case, in this scenario, a Data Communication Agreement should be signed between the target and the potential buyer or its advisors, that strictly limits the processing of personal data in the due diligence documentation. Note that if the buyer itself accesses any personal data during due diligence, it will have a duty to inform the data subjects. And where the signing parties are firms, the individuals accessing the personal data should also sign a confidentiality form as stated in sub-paragraph “a” above.

Failure to comply with GDPR and national provisions on personal data processing could result in a sanction from the corresponding European Supervisory Authority which could reach up to the greater of the following two amounts: 20 million Euros or 4% of the billing of the companies involved (or potentially their group of companies).

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1. **Best Live Music** – With D.C. native and musical legend Dave Grohl as a part owner, it’s no surprise that The Black Cat is the place to go in D.C. for indie and alternative music.


3. **Best Running Route** – There’s no better place than the National Mall. The 4.3 mile loop will take you past the Capitol, the Lincoln memorial, the Washington Monument and the buildings of the Smithsonian. “On your left”

4. **Best Cocktail** – CopyCat Co (H Street NE) is the place to go for a quality cocktail. What to order? Try the bartender’s choice, trusting in the bartender to choose based on your personal tastes and preferences. Or if you want to play it a bit safer try ordering a Rickey at any bar in town, did you know they got their start in D.C.?

5. **Best Eating Crabs** – Many wouldn’t consider a trip to D.C. from May to September complete without a bucket of blue crabs. It’s nothing fancy but for the best in town try checking out Maine Avenue Fish Market where you can buy a dozen and enjoy them on the waterfront.

6. **Best Art Space** – The REACH, the new expansion at the John F. Kennedy Center for the Performing Arts is celebrating its official opening with free programming until September 22nd. You can enjoy performances, artist talks or simply take in the expansive space, sculptures and installations.

7. **Best Hike** – Theodore Roosevelt Island may feel like a natural wonder with its marshes and boardwalks, but its actually a designed landscape made to feel like it’s naturally occurring. Located close to downtown D.C. the 88 acre island offers a variety of trails close to D.C.

8. **Best Shopping** – For the best shopping D.C. has to offer there’s no better place than Georgetown. From one of a kind boutiques to high end retailers it has a little bit of everything for everyone.

9. **Best Chicken Sandwich** – Does the Chick-fil-a vs Popeye's vs Wendy's social media frenzy have you scratching your head... but also secretly craving a fried chicken sandwich? If so D.C. has the solution for you, Roaming Rooster, a local alternative where business has been booming.

10. **Best Library** – The Library of Congress of course. And did you know that you can get a library card for the Library of Congress? Simply sign up at the library and you too can have access to the Library’s research areas and reading rooms.
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.

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