

CLIENT UPDATE

NOT OUT OF THE NET: M&A PITFALLS UNDER THE AIFMD FOR NON- EU ACQUISITIONS MADE BY NON-EU FUNDS

LONDON

Geoffrey P. Burgess
gpburgess@debevoise.com

David Innes
dinnnes@debevoise.com

Anthony McWhirter
amcwhirter@debevoise.com

Kenneth J. Barry
kbarry@debevoise.com

Philip Orange
porange@debevoise.com

The much-touted EU Alternative Investment Fund Managers Directive (“AIFMD”) comes into force on July 22, 2013. While its effects on fund raising from EU sources and deal activity in Europe have been carefully watched by fund managers everywhere, many may not appreciate that an investment by a non-EU fund outside the EU may also give rise to AIFMD considerations.

The AIFMD provides, in broad terms, that fund managers based in the EU must be authorised in order to manage or market alternative investment funds anywhere (“AIFs”), and fund managers based outside the EU must be authorised in order to manage AIFs based in the EU and to market AIFs in the EU.

The authorisation requirements for non-EU managers will phase in between 2015 and 2019 or thereabouts. However, starting on July 22, 2013 non-EU managers that market non-EU AIFs in the EU will nevertheless need to comply with the AIFMD’s disclosure and reporting requirements and asset-stripping restrictions, which apply to direct or *indirect* acquisitions of EU entities. Non-EU managers that form an acquisition vehicle or a co-investment vehicle based in the EU or that raises capital from EU investors will also need to consider whether the vehicle itself might be treated as an AIF.

NOTIFICATION AND ASSET-STRIPPING OBLIGATIONS

The notification and asset-stripping obligations apply to a non-EU fund's investment in a target outside of the EU if (i) the non-EU manager markets after July 22, 2013 the relevant non-EU AIF in the EU and (ii) the target company has one or more EU subsidiaries. If the non-EU manager has not marketed the AIF in the EU after July 22, 2013, then these rules will not apply even if the target company has EU subsidiaries. Conversely, the notification and asset-stripping rules will not apply – no matter who the manager or AIF – to investments in targets outside of the EU with no EU subsidiaries or operations. If the target includes EU subsidiaries, the notification and asset-stripping rules apply only for those EU subsidiaries.

These requirements do not apply to acquisitions of interests in small and medium enterprises, i.e., companies with fewer than 250 employees and an annual turnover of up to €50 million or a balance sheet total of up to €43 million.

Notification. If an AIF acquires control of an EU portfolio company, the manager must disclose to the company, its shareholders and its regulator the identity of the manager; the policy for preventing and managing conflicts of interest between the manager, the AIF and the company; and the company's communication policy, "in particular as regards employees". (A non-EU manager's regulator will generally be the regulator of the EU member state where the manager intends to focus its fund marketing activities.) The manager must also disclose to the EU company and its shareholders its intention with regard to the future business of the company, and the likely repercussions on employment, and must provide its regulator and the AIF's investors with "information on the financing of the acquisition."

A non-EU manager must also notify the EU company, its shareholders and the manager's regulator within 10 working days of acquiring "control" of a portfolio company, and must disclose (i) the resulting situation in terms of voting rights, (ii) the conditions under which control was acquired, including information about the different shareholders involved and (iii) the date on which control was acquired. For this purpose, "control" of a subsidiary generally means holding more than 50% of the voting rights, either alone or in combination with other AIFs, of a privately held parent company. The rules for "control" of a subsidiary of a non-EU public company are less clear and require an analysis of control under the laws where the parent is organised and listed.

In addition, the notification requirements provide that a fund manager must notify its regulator within 10 working days when the proportion of voting rights of a non-listed

portfolio company held directly by the fund manager's AIF (or indirectly by entities controlled by the AIF) reaches, exceeds or falls below certain thresholds (10%, 20%, 30%, 50% and 75%).

Asset stripping. For two years following the direct or indirect acquisition of control by an AIF of an EU portfolio company, the manager managing the AIF will be subject to restrictions on "asset stripping". Specifically, the manager must not facilitate, support or instruct, must not vote in favour of, and must use its best efforts to prevent, any distribution to shareholders, capital reduction, share redemption or share buy-back by the portfolio company where the net assets would fall short of the portfolio company's subscribed capital and non-distributable reserves or profits. A capital reduction for this purpose does not, however, include a reduction in subscribed capital the purpose of which is to offset losses incurred or to include sums of money in a non-distributable reserve of not more than 10% of the reduced subscribed capital.

These provisions were introduced at a late stage of the AIFMD negotiations and are short on detail. In the United Kingdom, HM Treasury has issued draft regulations which partially clarify the circumstances where the asset-stripping restrictions apply. The United Kingdom Financial Conduct Authority (the "FCA") is also considering issuing guidance on the issue.

IDENTIFYING POTENTIAL AIFS IN AN ACQUISITION STRUCTURE

Structures set up to acquire interests in portfolio companies often include multiple entities in different jurisdictions. Such vehicles could be introduced for tax purposes and/or to separate the interests of different categories of investors and debt providers. In view of the wide definition of an "AIF" in the AIFMD (as summarized below), a non-EU manager that forms an acquisition vehicle or a co-investment vehicle based in the EU or that raises capital from EU investors will need to consider whether any such vehicle might itself be an AIF. If so, they will need to identify its manager and consider whether the manager is subject to the AIFMD, and will need to comply with any relevant AIFMD requirements.

The AIFMD defines an AIF as any "collective investment undertaking", including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which is not a UCITS. The legal form or structure of the investment undertaking does not matter. An AIF may be open-ended or closed-ended. Guidelines issued by ESMA confirmed a broad meaning for a "collective investment undertaking".

But there are some exclusions. These include single investor funds (provided they are constitutionally limited to one investor), employee participation schemes, securitisation special purpose entities and “holding companies”, defined as companies with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy or strategies through their subsidiaries.

The exclusions are helpful, but grey areas remain and it is not clear from the current EU legislation whether, for example, joint ventures, club-deal vehicles or co-investment vehicles will be treated as AIFs. In the United Kingdom, the FCA has issued its own detailed guidance (currently still in draft form) which suggests that, for example, joint ventures, family investment vehicles, co-investment vehicles, carried interest vehicles and acquisition vehicles will not normally be caught by the definition. However, other member states may take a different view and, until such time as ESMA harmonizes the different interpretations, fund managers may need to consider how an AIF is defined in the legislation of different member states.

* * *

Please do not hesitate to contact us with any questions.

June 26, 2013