Private Equity Report

WHAT'S INSIDE

"It's very important that you try very, very hard to remember where you electronically transferred Mommy and Daddy's assets."

Mitigating Cyber Threats to Private Equity Firms and Their Portfolio Companies

Like other businesses today, private equity firms and their portfolio companies increasingly face serious data security threats – for example, from individual hackers, from organized criminal enterprises and even from their own employees or vendors.[1] We all know from recent press reports that a data security breach can seriously harm the reputation and reduce the value of the affected business. Firms that fail to take cyber threats seriously face very real reputational risk and the potential loss in value of the private equity firm or one or more of its portfolio companies. Unremitting efforts by senior management and boards to combat these threats should be seen not only as good business but also – with regulators (including the SEC), courts and the plaintiffs' bar increasingly bearing down on perceived lapses in data protection – as a legal necessity. That reality was driven home by two recent SEC actions. First, in September 2015, the SEC announced that it would be focusing on cybersecurity practices of

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1. In August 2015 Debevoise & Plimpton LLP published a compilation of articles and client updates covering the range of cybersecurity issues facing businesses today. See http://www.debevoise.com/insights/news/2015/09/debevoise-publishes-breach-reading.

regulated entities during upcoming exams. Later the same month (and, some have speculated, not coincidentally) the SEC announced the settlement of a case in which it charged an investment adviser with failing to maintain adequate cybersecurity policies and procedures.

In the Spring 2015 issue of *The Debevoise & Plimpton Private Equity Report*, we discussed some of the steps that private equity firms should take pre-acquisition to assess cybersecurity risks presented by a potential portfolio investment.[2] In this issue, we outline some of the steps that private equity firms can take to combat cyber threats to the firm itself, and to portfolio companies post-acquisition. One size does not fit all, of course. Cybersecurity protections must be tailored to the size of a private equity firm (including the funds it manages); the size and nature of the businesses of its portfolio companies; and the types and volume of data it and they maintain. Still, private equity firms of all types and sizes can look to a common set of basic measures to manage their cyber risks, both business and legal.

> "Cybersecurity protections must be tailored to the size of a private equity firm (including the funds it manages); the size and nature of the businesses of its portfolio companies; and the types and volume of data it and they maintain."

At the Firm (and Fund) Level

KYA2. We call the basic cybersecurity starting point "KYA2": "Know Your Assets" and "Know Your Architecture." Identifying *what* you have (assets) and *where* you keep those assets (architecture) are fundamental when it comes to cybersecurity.

Under the heading of "Know Your Assets," the task is to catalog what sort of data the firm collects from all of its various constituents and counterparties, from limited partners (LPs) to employees to vendors to acquisition targets to portfolio companies. At the firm level, those assets can include sensitive personal and financial information of founders and other employees; data concerning LPs, such as data gathered to satisfy KYC/AML requirements; material non-public information about portfolio companies that is held by the firm, including those companies' business plans and financial data; and confidential information about the firm's own strategy, potential fund investments and portfolio company exit plans.

Under the heading of "Know Your Architecture," the task is to document where exactly the firm stores this sensitive information (*e.g.*, internally, off-site, with a third-party cloud provider or using an application services provider); what measures are taken to protect the data (*e.g.*, encryption of particularly sensitive information); whether the network is "segmented" so that an intruder who gets in the front door does not have the run of the whole house; whether especially sensitive data is segregated in a particular storage location as opposed to (for instance) being combined for convenience with other data on a computer server that has unused storage space; who has access to different types of data and by what means; and whether stale files are periodically purged. This last point is simple but all-important: criminals can't hack – and you can't lose – what you don't have.

Plan, Prepare, Test, Repeat. Once you know what assets you possess, and where they are maintained, you can develop a plan (working with cyberforensics consultants and experienced counsel) to protect those assets by implementing appropriate controls and by testing those controls to ensure they are working as expected. Well-recognized benchmarking standards, such as the Cybersecurity Framework promulgated by the National Institute of Standards and Technology ("NIST"), the SANS-20 Critical Security Controls or ISO 27001, can help guide that process. Once

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2. See "'Dealing' with Cybersecurity: Evaluating Transactional Risk," *The Debevoise & Plimpton Private Equity Report*, Spring 2015, http://privateequityreport.debevoise.com/the-private-equity-report-spring-2015/dealing-with-cybersecurity.

Guest Column (Aon):

Are You Covered? The Rise of M&A Insurance Policies

"Transaction liability insurance has been around for a few decades, but has only recently become recognized as an effective tool that can help get transactions done on better terms for all parties involved."

Countless articles have been written over the past year about the merits of using insurance in the context of M&A transactions, including not only policies that insure representations & warranties ("R&W"), but also those covering tax, litigation, fraudulent conveyance, successor liability and other contingent risks. At a minimum, most sophisticated M&A practitioners now understand the value proposition of deploying an R&W insurance policy in place of, or in tandem with, a traditional indemnity for breaches of representations & warranties. And those that don't will certainly soon realize that their deal-making toolkit is woefully lacking, as the use of insurance to effect transactions is not just a fad or trend, but rather a deal mechanic that we believe will eventually be as much a part of the fabric of M&A as working capital adjustments and closing dinners.

A number of trends have been developing with respect to the use of these insurance products. The purpose of this article is to explore some of those trends in the current market.[1]

R&W Insurance – An Overview

Buy-side R&W insurance allows the buyer in an M&A transaction to look to an insurance policy in the event of unknown breaches of representations & warranties for a fixed premium.[2] In exchange for that premium, the R&W insurers will provide coverage above a self-insured retention (akin to a deductible) in the event of covered breaches discovered after inception of the policy. Below is an example of what a typical R&W policy might look like:

Enterprise Value		$100,000,000
Premium		$ 400,000
Indemnity Cap/Escrow	1%	$ 1,000,000
Policy Limit	10%	$ 10,000,000
Total Protection	11%	$ 11,000,000

In the above table, the total purchase price of the target company is $100 million. The seller, in this case, is providing an indemnity capped at 1% of the purchase price. This indemnity cap, along with any deductible being borne by

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1. A high-level summary of the suite of transaction liability insurance products is set forth at the end of this article.

2. Sell-side R&W insurance is far less common and will provide a backstop to an indemnity/escrow arrangement, as opposed to replacing it or bolstering it. From a seller's perspective, the benefit of a sell-side policy is that it provides "sleep at night" comfort, guaranteeing that the escrow (over and above some deductible) will be there when the reps under the agreement lapse. It does not, however, free up money from the escrow and thus is not as valuable to a seller focused on opportunity cost/cost of capital.

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the buyer under the indemnification provisions of the purchase agreement, will comprise the self-insured retention under the policy (*e.g.*, if the deductible is 1% of the purchase price, the total retention from the insurer's perspective will be 2% of the purchase price). On top of that, the buyer is seeking protection for up to 10% of the purchase price in order to replicate what they might obtain under a typical indemnity structure with a strategic seller. In the event that loss is experienced for a breach (or series of breaches) of the seller or company representations & warranties in excess of $1 million, the policy will be available and make the buyer whole (subject to the policy limit) for that loss. The cost of this coverage is typically a one-time fee of 3.5%-4.5% of the limit being purchased.

The goal of R&W insurance is to cover the full suite of representations & warranties given by the seller and/or the company in the purchase agreement.[3] The policy typically serves to extend the survival of these representations & warranties beyond customary terms (particularly in sponsor sales), as the policies usually run for three years for general representations and six years for fundamental and tax representations. The scope of coverage can substantially mimic what would be available under a typical indemnification arrangement and in some ways go beyond (*e.g.*, a buyer can obtain coverage up to the full purchase price for breaches of any R&W, not just fundamental R&W). Policies are put in place within the typical transaction timeline, with the the process running less than two weeks from start to finish (and in certain situations, the policies can be put in place much more quickly).

Of course, a well-crafted insurance policy only has true value if it performs in the event of a loss. One concern about R&W insurance is that carriers will look to exclude claims. While there are limited published figures on this, we can report that so far insurance carriers have generally paid out on valid claims. One carrier alone paid out over $100 million in claims last year globally in respect of R&W policies. One of the few things that can stop the momentum the product has garnered is if carriers stop paying valid claims. All insurers recognize the critical importance of good claims practices and to date we have not had issues getting valid claims paid. We believe that the carriers will continue to prioritize the importance of good claims practices and we are optimistic that valid claims will continue to be paid.

Clean Exits

Every seller of a business dreams of achieving a "sky high" valuation when they decide to sell. But price is actually only one piece of the puzzle. A large escrow or indemnity cap coupled with a long survival period for the representations & warranties can make an otherwise great deal seem less attractive. Indeed, sellers in hot auction processes have long tried to convince bidders that their asset was worthy of a completely clean exit, a structure that has historically been reserved only for public companies (and only there largely due to the impracticalities of seeking recourse against a disparate shareholder base) and certain large private companies owned by private equity firms. Rarely were sellers of companies in the middlemarket able to effect the same style exit and instead often found themselves faced with post-closing indemnity exposure capped at 5-20% of purchase price, which survived for one to three years (and was often supported by a cash escrow, depending on the identity and creditworthiness of the sellers). When middle-market sellers tried to be aggressive by suggesting that they would not accept bids with any form of post-closing indemnity, they usually found themselves facing an uphill battle as few serious bidders were willing to go completely "naked" on a private company acquisition.

Enter R&W insurance and the "seller flip" construct, which was first introduced in 2012 and under which a seller sought to achieve an almost completely clean exit. With the introduction of R&W insurance, sellers suddenly were able to line up an alternative to a large post-closing indemnity that gave buyers the protection they sought while allowing the seller to maximize cash proceeds at closing. At the start of an auction process, a seller would

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3. Nearly every policy contains exclusions for matters actually known to the insured or disclosed on the disclosure schedules, forward-looking statements, covenants, working capital adjustments, asbestos and polychlorinated biphenyls, and pension underfunding and withdrawal liability.

The High Price of Disloyalty: New York's "Faithless Servant" Doctrine

"Under the venerable, but not widely appreciated, 'faithless servant' doctrine, a disloyal employee in New York may be required to disgorge compensation during the period of disloyalty."

Employers in New York State, among them many financial sponsors and their portfolio companies, have an extraordinarily powerful legal weapon at their disposal to wield against employees found to have engaged in disloyal conduct. Under the venerable, but not widely appreciated, "faithless servant" doctrine, a disloyal employee in New York may be required to disgorge compensation during the period of disloyalty.

In its strictest form, the doctrine can lead to the harsh penalty that the employee must disgorge *all* compensation earned since the date of the first act of disloyalty. Courts applying this strict form of the doctrine have held expressly that any value provided by the employee through loyal service is irrelevant and that the employer need not prove damages, causation or any proportionality between the harm caused by the disloyal conduct and the compensation to be disgorged. Rather, the doctrine works mechanically. The date of the first disloyal act is determined and every cent of compensation earned since that date must be disgorged. So, if an otherwise valuable executive is found to have engaged in an improper self-dealing transaction three years ago, the executive may be required to pay back all compensation earned during the past three years even if the harm caused by the self-dealing transaction was minimal and regardless of whether the executive otherwise provided valuable service during the period.

Some courts have recognized possible limitations on the strictest form of the doctrine. Under one such line of authority, disgorgement is required only if the disloyalty "permeated the employee's service in its most material and substantial part." Under this more nuanced approach, there is room for the employee to craft an argument that any disloyalty should be balanced against the value of legitimate services provided by the employee. Another line of authority may support an argument that disgorgement should be apportioned either by pay period or by task. Under this approach, a disloyal employee would be required to disgorge compensation only from pay periods in which misconduct occurred, or, if the employee is paid on a per-task basis, disgorgement would be required only as to those tasks that were performed disloyally.

Notwithstanding the fact that courts have recognized these possible limitations, the strictest form of the doctrine remains viable. As recently as 2013, courts have observed that conflicting standards persist under the case law and have

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not yet been reconciled. Thus, employers may continue to advocate for, and employees will continue to have exposure to, application of the doctrine in its strictest form.

"Employers may assert the doctrine in any of the myriad factual scenarios in which employer-employee conflict arises. For example, an employer may invoke the doctrine when negotiating a separation package; as a counterclaim when an employee has sued or threatened to sue for wrongful termination, breach of contract or some other claim; or when pursuing an employee for having set up a competing business at a time when the employee was still employed and still owed undivided loyalty to the employer."

The doctrine has been asserted across a broad array of job categories, ranging from CEOs, to investment professionals, to low-level employees. The predicate act of "disloyalty" that can trigger application of the doctrine is any conduct that could give rise to a claim for breach of fiduciary duty, including, for example, any improper self-dealing transaction, any taking of unauthorized compensation or perquisites, or any usurpation of corporate opportunities. Employers may assert the doctrine in any of the myriad factual scenarios in which employer-employee conflict arises. For example, an employer may invoke the doctrine when negotiating a separation package; as a counterclaim when an employee has sued or threatened to sue for wrongful termination, breach of contract or some other claim; or when pursuing an employee for having set up a competing business at a time when the employee was still employed and still owed undivided loyalty to the employer.

There may, of course, be circumstances in which an employer would be reluctant to file a public litigation detailing the ways in which an employee has misbehaved. Such a public airing of dirty laundry can have reputational and business consequences for the employer. Concerns about these types of adverse consequences may be less compelling, though, if the employee's misconduct is already in the public record because the employee is being charged criminally or is the subject of other litigations or investigations. Any such concerns also may be minimized if the employer and the employee have an agreement to resolve any disputes through confidential arbitration rather than in court.

In any event, even if the employer is ultimately unwilling to file a claim against the employee under the "faithless servant" doctrine, the mere threat of doing so – given the draconian nature of the remedy – may provide the employer with substantial leverage to achieve a favorable negotiated outcome.

Situations of this kind are fortunately uncommon, but when they do arise they can be corrosive to an organization, costly and painful to work through. Private equity firms take note. If a "faithless servant" appears in your midst, you may have more recourse than you think.

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Bond Restructuring Challenges

"[T]hese decisions may force more companies into bankruptcy or, at a minimum, increase the execution risk and related costs of out-of-court bond restructurings."

In several recent decisions, two judges on the United States District Court for the Southern District of New York adopted an interpretation of the Trust Indenture Act of 1939 (the "TIA") that can be expected to complicate future exchange offers and, in some cases, force bond restructurings that might otherwise have been completed out-of-court to be effectuated through a bankruptcy filing. These decisions have been appealed to the United States Court of Appeals for the Second Circuit, but given the approach taken by the Southern District courts in interpreting the TIA, reorganizing issuers would be well advised to pay close attention to this significant change in the financial restructuring landscape.

Marblegate Facts

Education Management Corporation ("EDMC") is a large for-profit provider of college and graduate education. Faced with deteriorating finances, EDMC sought to restructure approximately $1.522 billion in secured loans and unsecured notes, both issued by its subsidiary Education Management LLC and guaranteed by EDMC. Because EDMC would lose its entitlement to funds under federal student aid programs if it filed for bankruptcy, the restructuring had to be accomplished out-of-court.

To this end, EDMC negotiated a restructuring with its creditors that contemplated two possible transactions. If 100% of EDMC's creditors consented, secured lenders would receive a combination of cash, new debt and preferred stock and noteholders would receive preferred stock. If 100% consent was not obtained, secured lenders would release EDMC's guarantee of their loans (which under the indenture governing the unsecured notes would automatically release EDMC's guarantee of the notes), foreclose on substantially all of EDMC's assets and then sell the assets back to a new subsidiary of EDMC, in exchange for new debt and equity to be distributed only to consenting creditors. Non-consenting holders of unsecured notes would lose the benefit of the EDMC guarantee and would be left with claims against an entity that no longer held any assets.

While 99% of the secured lenders and over 90% of the noteholders consented to the first option, EDMC was forced to pursue the nonconsensual alternative. The plaintiffs were among the holdouts and sought a preliminary injunction to enjoin the restructuring ("*Marblegate I*"). The court denied the preliminary injunction and, later, following the provision of extensive supplemental briefing, it affirmed its earlier position that the proposed restructuring was prohibited by the TIA ("*Marblegate II*").

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Caesars Facts

Caesars Entertainment Corporation ("CEC") and its subsidiaries, including Caesars Entertainment Operating Company, Inc. ("CEOC"), owns and manages dozens of casinos in the United States. CEOC issued $750 million in senior unsecured notes due in 2016 and $750 million in senior unsecured notes due in 2017. The notes were guaranteed by CEC.

In August 2014, with a restructuring on the horizon, CEOC and CEC purchased a substantial portion of the notes at par plus accrued interest in a private transaction. In exchange, the holders of these notes agreed to support a future restructuring of CEOC, including the release of CEC's guarantees. The plaintiffs were noteholders (and bond trustees suing on their behalf) that were not invited to participate in the deal. Due to the amount of CEOC's secured debt, with the release of the guarantee by CEC, the plaintiffs faced losing the only source for repayment on the unsecured notes. The plaintiffs sued CEC and CEOC on the theory that the release of the parent guarantee violated the TIA and the TIA-qualified indentures. The court denied Caesars' motion to dismiss noteholder claims, even though release of a parent guarantee was allegedly permitted under the indenture's amendment provision ("*Caesars I*"). In a later opinion denying summary judgment to noteholders, the same court analyzed the appropriate evidentiary showing required to prove a TIA claim ("*Caesars II*"). In January 2015, CEOC and 172 of its subsidiaries (but not CEC) filed for chapter 11 bankruptcy protection.

District Court Decisions

As generally understood prior to these recent decisions, the TIA only protects a legal right to *seek* payment by protecting each holder against amendments of certain "core terms" not implicated in either decision, such as the indenture's payment terms, that are consented to by a majority of holders. After a review of an unpublished district court decision and the TIA's legislative history, the *Marblegate I* court reasoned that the TIA should be read as "a broad protection against nonconsensual debt restructurings," protecting each noteholder's "substantive right to actually obtain" payment and not merely the "legal entitlement to demand payment."

Applying this expansive interpretation of the TIA, the *Marblegate I* court found that the nonconsensual restructuring would "effect a complete impairment of dissenters' right to receive payment" and therefore likely would be illegal under the TIA. The court further stated that Section 316(b) of the TIA "was intended to force bond restructurings into bankruptcy where unanimous consent could not be obtained." Relying on this reasoning, the *Caesars I* court held that, as alleged, the removal of the parent guarantee was "an impermissible out-of-court debt restructuring achieved through collective action. This is exactly what TIA Section 316(b) is designed to prevent."

Addressing the TIA issue, the *Marblegate II* court framed the question, "[D]oes a debt restructuring violate Section 316(b) of the Trust Indenture Act when it does not modify any indenture term explicitly governing the right to receive interest or principal on a certain date, yet leaves bondholders no choice but to accept a modification of the terms of their bonds?" The court answered in the affirmative and even though TIA Section 316(b) is silent as to the precise kinds of restructurings that are prohibited, the court had no trouble holding that the Marblegate restructuring did so by offering holdouts no choice but to take the deal or to get nothing.

> "Given the breadth of the rationale in these cases and the resulting uncertainty with respect to the feasibility of out-of-court restructurings, issuers have another disincentive to register their bonds with the Securities and Exchange Commission...."

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UK FATCA and CRS: Grappling with More Tax Forms

"Once the can was opened, the worms started to escape. Now it is common to see not just a FATCA form but also a 'UK FATCA' or 'CDOT' form in many subscription document packs."

No one likes forms … especially tax forms.

Since the United States introduced the Foreign Account Tax Compliance Act ("FATCA") into the world, FATCA forms have become ubiquitous among private funds; GPs are required to request them for non-US fund vehicles and investors are required to complete them. Once the can was opened, the worms started to escape. Now it is common to see not just a FATCA form but also a "UK FATCA" or "CDOT" form in many subscription document packs. This form, for the uninitiated, relates to the automatic exchange of tax information agreements entered into between the UK and its Crown Dependencies and Overseas Territories (most importantly, Cayman, Jersey and Guernsey).

The theory behind automatic exchanges of information is that the vast quantity of taxpayer information that is collected is then exchanged between the relevant tax authorities. For FATCA purposes, the exchange is currently either one-way or two-way, depending on the jurisdiction, and for UK FATCA purposes, the exchange is currently two-way between both Jersey and Guernsey and the UK, but only one-way between the Cayman Islands and the UK. The information exchanged is intended to enable local tax authorities to determine whether its residents have taxable overseas income or gains that are not being reported. FATCA has teeth behind it in the form of a 30% withholding tax, whereas UK FATCA has the threat of relatively low-level monetary fines.

The "beauty" with UK FATCA is that it is based on FATCA. Once a person grasps FATCA, including its complications and definitions, then getting a handle on UK FATCA is much easier. But this beauty is only skin deep – too much familiarity with FATCA can lull one into a false sense of security toward UK FATCA. FATCA and UK FATCA are not exact replicas. For example, a US entity cannot be a passive NFFE (non-financial foreign entity) for FATCA purposes but can be a passive NFE (non-financial entity, which is UK FATCA's equivalent) for UK FATCA purposes. This can give rise to some head-scratching on the part of investors when completing UK FATCA forms as it's not simply a case of transposing answers from the FATCA form to the UK FATCA form. It also means that an IRS W-8 form is not itself sufficient for UK FATCA.

UK FATCA forms have been around for about a year and many investors have completed at least one; however, more change is coming. UK FATCA forms will be phased out and OECD Automatic Exchange of Information Common Reporting Standard ("CRS") forms will be phased in. The Q&A below serves as a warning that new tax forms will start appearing in the coming months and aims to equip readers with enough information to spot a CRS form and understand its purpose.

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1. What is the CRS?

Under the CRS, financial institutions in participating countries will be required, as under FACTA, to collect and report annually financial account information in respect of investments controlled by reportable accountholders in other participating countries. As with FATCA, reports need to be made about both individuals and entities and there is a requirement to look through passive entities to the individuals who ultimately control such entities (referred to as controlling persons). These reports need to be made to the financial institution's local tax authority (or authorities, if dual resident) who will exchange this information with the relevant participating tax authorities around the world.

2. Which countries are participating?

A long list of countries have signed up to automatic exchange of information. At the time of writing, c. 100 countries have done so, including all EU member states, many of the Caribbean islands, Russia, China and Canada.

Notable exceptions are the United States, the Middle East and most of Africa. The United States has stated that it intends to move toward mutual exchange of information using its network of intergovernmental agreements entered into for FATCA purposes.

3. What information needs to be collected/exchanged?

Fairly anodyne information such as name, address, tax identification number(s), date and place of birth are required (as applicable). All relevant jurisdictions of residence are also required together with details of the account holder's account, including the account number, account balance and any investment income (including dividends, interest, income from certain insurance contracts and "similar" income) and proceeds from sales of financial assets.

"A long list of countries have signed up to automatic exchange of information. At the time of writing, c. 100 countries have done so, including all EU member states, many of the Caribbean islands, Russia, China and Canada."

4. When does information exchange begin?

For 58 countries, information regarding the year ending 31 December 2016 needs to be exchanged by September 2017. For the remaining countries, information for the year ending December 31, 2017 needs to be exchanged by September 2018.

5. How does this affect the private equity industry?

Funds resident in participating countries will need to collect information from investors and make reports. A sponsor with funds across a number of different jurisdictions may need to collect slightly different information for each jurisdiction as there may be slight variances in the definitions in each jurisdiction's implementation of the CRS.

The slightly wider remit of the CRS compared to FATCA means that some funds may be caught by CRS that are not caught by FATCA; this is not only a geographic question but also a definitional one. For example, it is possible that listed funds may be within the CRS whereas certain listed funds fall outside of FATCA.

For investors, the effect will be the requirement to complete an additional tax form; as with FATCA/UK FATCA it may take a while for an industry practice to develop regarding the format of the form, and therefore each form may take a significant amount of time to complete.

6. How does CRS differ from FATCA?

The most striking difference is that there is no withholding tax backing up the CRS.

More subtly, the CRS is somewhat broader in scope than FATCA; the

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Russia Transforms the Legal Landscape for Private Equity Deals

"Amendments to the Civil Code, which came into effect on June 1, 2015, introduced a number of provisions that are quite novel for Russian law and permit parties to agree and enforce representations on a wide variety of matters, including business representations, compliance and authority."

Russian civil and corporate laws are undergoing significant changes that will have an impact on M&A deals involving Russian companies. This article provides a quick overview of those amendments, which are likely to be relevant for private equity firms active in Russia.

Changes Affecting Transaction Documents and Negotiations

Acting and Negotiating in Good Faith

Russian law now has an explicit general principle of acting in good faith that applies to all civil law relations, including corporate governance. In particular, it is prohibited to enter into or continue negotiations without an intention to reach agreement, to remain silent about material conditions or to provide incomplete or incorrect information, to cease negotiations abruptly and unreasonably and to use information provided by the other party to the negotiations in an improper fashion in one's own interests. A party breaching these provisions is liable to compensate the other party for its losses arising from the breach.

Representations, Warranties and Indemnities: Now Possible Under Russian Law

Amendments to the Civil Code, which came into effect on June 1, 2015, introduced a number of provisions that are quite novel for Russian law and permit parties to agree and enforce representations on a wide variety of matters, including business representations, compliance and authority. A misrepresentation entitles the other party to claim compensation for losses or payment of damages set out in the contract and, in certain cases, rescission of the contract. The Civil Code now also contains provisions governing "indemnification of losses," which allow the parties to agree in a contract that one party will indemnify the other for losses arising from circumstances set out in the contract (other than a willful breach of the contract by a party, where other available remedies, such as damages, continue to apply). Such circumstances may include an inability to perform a contract, or claims from third parties or governmental authorities against a party to the contract or a third party, *e.g.*, a subsidiary. The amount of the indemnity or the procedure for its calculation must be set out in the contract. The amendments have also introduced additional flexibility into contractual undertakings subject to conditions, where it is now possible to have a condition solely dependent on the will of one of the parties, and also in relation to option agreements, which were not previously expressly regulated by law.

Shareholders' Agreements

New provisions now govern "corporate agreements," which will apply to any shareholders' agreement, whether in respect of a limited liability company or a joint stock company. In particular, it is now expressly provided that creditors

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and other third parties can be party to corporate (shareholders') agreements. Furthermore, resolutions of a company's governing bodies can be invalidated if taken in breach of a shareholders' agreement, provided that all shareholders of a company are party to the agreement, which is often the case in joint ventures and private equity deals. Similarly, transactions by a party to a shareholders' agreement that are in breach of such agreement can be invalidated, provided that the counterparty knew or should have known of the limitations in the shareholders' agreement. From this standpoint, investors will need to consider if information on the shareholders' agreement should be publicly disclosed.

Changes Affecting Corporate Governance

Public and Non-Public Companies

There is no longer a division of joint stock companies into closed and open joint stock companies. Russian corporate entities are now divided into public and non-public entities. Under the Civil Code, joint stock companies can be public or non-public, while limited liability companies can only be public.

As would be expected, the corporate governance of non-public companies is more flexible than for public companies. By way of example, a non-public company need not have a board of directors; the corporate powers of its shareholders' meeting may be expanded or restricted; statutory rules for holding board and shareholder meetings can be amended by a company's charter; and the charter may restrict the maximum number of shares or votes held by one shareholder. This flexibility is beneficial, as it allows shareholders to fine-tune various corporate rules to better reflect their specific needs.

Company's Management

Until recently, the only person authorized to represent a Russian company, without a power of attorney was its sole executive body (the CEO or the General Director). A company can now have several persons, acting either jointly or independently, to represent the company vis-à-vis third parties without a power of attorney.

Can a Shareholder/Participant Be Expelled from a Company?

The Civil Code now allows any shareholder in a non-public company to demand that another shareholder be expelled from the company, via a court procedure, if the actions or inactions of the shareholder result in damage to the company, or otherwise materially complicate or jeopardize the activities of the company or the attainment by the company of the purposes for which it was established, including through gross violation by such shareholder of its obligations under the law or the company's charter.[1] An expelled shareholder is paid the "actual" value of its share in the company by the company. The Civil Code does not specify how actual value is calculated; however, precedent suggests it will be calculated based on the value of the company's net assets. The operation of these provisions has not yet been tested and will require further study and clarification.

Liability of Persons Able to Exercise Influence over a Company

As a result of recent amendments to the Civil Code, a person that is effectively capable of determining the actions of a legal entity, including the right to give directions to its governing bodies, must act in the interests of such legal entity, reasonably and in good faith. A person that fails to do so can be held liable for damages to the company. This is a general principle, the implementation of which remains unclear and will to a significant extent depend on court practice; therefore, investors in a Russian company will need to carry out a careful analysis to ensure that this risk is properly understood and addressed to the extent possible.

Broader Rights of Board Members

The Civil Code now explicitly provides that a board member is entitled, among other things, to receive information about the company, to file claims on behalf of the company for damages caused by wrongful actions of the controlling shareholder or other members of the company's governing bodies or to challenge transactions

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1. Note that under the amended Civil Code shareholders are obliged, among other things, to participate in making decisions without which a company cannot continue to operate; not to disclose confidential information about the company; and not to take actions or inactions that make it impossible for the company to reach the goals for which it was created.

Consultation on UK Limited Partnership Law Reform: A Leap into the 21st Century?

"[T]he proposed amendments *would* bring UK limited partnership law into line in certain key respects with limited partnership law in other jurisdictions in which private funds are typically established (such as the Cayman Islands, the Channel Islands, Delaware and Luxembourg)."

Introduction

On 23 July 2015, HM Treasury published a consultation paper on certain proposed amendments to the Limited Partnerships Act 1907, the principal legislation governing English and Scottish limited partnerships (the "1907 Act"). The proposed amendments are intended to "ensure that the UK limited partnership remains the market standard structure for European private equity and venture capital funds as well as many other types of private fund."[1]

The consultation comes after extensive discussions between the British Private Equity & Venture Capital Association (the "BVCA") and HM Treasury regarding the state of current UK limited partnership law. Debevoise & Plimpton and a number of other market participants assisted the BVCA with this process. The consultation period came to an end on 5 October 2015.

Brief History of Past Failures

The 1907 Act has remained in force with only minor amendments since its enactment. However, this is not the first attempt to reform UK limited partnership law in recent years.

In 2003, the Law Commission and the Scottish Law Commission[2] (together, the "Law Commissions") undertook a detailed review of UK partnership law (covering general partnership law and limited partnership law) and made a number of recommendations to the UK government. In 2008, the predecessor to the Department of Business, Innovation and Skills ("BIS") consulted on wide-ranging reforms, based largely on the Law Commissions' recommendations in 2003. That consultation resulted in only limited amendments to the 1907 Act.

The amendments proposed in HM Treasury's current consultation are technical in nature. They do not, and are not intended to, go so far as those proposed in 2003 or 2008. If enacted, however, the proposed amendments *would* bring UK limited partnership law into line in certain key respects with limited partnership law in other jurisdictions in which private funds are typically established (such as the Cayman Islands, the Channel Islands, Delaware and Luxembourg).

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1. As an aside, technically there is no such vehicle as a "UK limited partnership." There are two different forms of limited partnership governed by the 1907 Act that are commonly utilised in the private fund context – English limited partnerships and Scottish limited partnerships. The primary difference between an English limited partnership and a Scottish limited partnership is that the former does not have separate legal personality. In this article, any reference to a UK limited partnership is a reference to both an English and a Scottish limited partnership.

2. The Law Commission and the Scottish Law Commission are independent bodies established to keep English law and Scottish law, respectively, under review and to recommend reform where it is needed.

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Application of the New Regime

Private Fund Conditions

If enacted, the proposed amendments will apply only to UK limited partnerships that are "private fund limited partnerships" (a new statutory concept). A UK limited partnership will be capable of qualifying as a private fund limited partnership if the following conditions (the "private fund conditions") are satisfied:

- the limited partnership is constituted by a written agreement, and
- the limited partnership is a "collective investment scheme" (or would be but for the group exemption).[3]

"The consultation proposes introducing a 'white list' of activities that a limited partner of a private fund limited partnership may perform without jeopardising its limited liability status."

These are not difficult conditions for a private fund to satisfy. The purpose of the private fund conditions is not to create a particularly narrow new regime; rather, it is to ensure that the new regime is one that applies to private investment funds and not to any other type of vehicle that may take the form of a UK limited partnership. This is because, in general, UK limited partnership reform falls within the remit of BIS. However, after it received mixed feedback to its 2008 consultation, BIS declared that it would not pursue any further reforms to UK limited partnership law (other than the limited reforms that were enacted in 2009). HM Treasury is able to reform UK limited partnership law insofar as that reform would benefit the UK asset management industry. Accordingly, the proposed new regime is intended to impact a subset of UK limited partnerships only, *i.e.*, those that are used for private funds.

One-Off Elective Regime

It is not mandatory for a UK limited partnership that satisfies the private fund conditions to be designated as a private fund limited partnership and so fall within the new regime. If a UK limited partnership satisfies the private fund conditions, the general partner of that limited partnership may elect for that limited partnership to be designated as a private fund limited partnership either (*i*) in the case of a UK limited partnership registered after the proposed amendments are enacted, at the time of registration or (*ii*) in the case of an existing UK limited partnership, within one year after the proposed amendments are enacted.[4] If such election is not made, the UK limited partnership (even where it satisfies the private fund conditions) will not fall within the new regime.

It is not possible for a private fund limited partnership to be re-designated as a (non-private fund) limited partnership. Once designated as a private fund limited partnership, the private fund conditions are not tested on an ongoing basis.

Proposed Scope of the New Regime

The most noteworthy of the amendments proposed in the consultation are summarised below.

Adoption of a "White List"

Currently, if a limited partner of a UK limited partnership takes part in the management of the partnership business, it will have unlimited liability for the debts of that limited

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3. A common theme in a number of responses submitted in respect of the consultation was that the "collective investment scheme" condition should be further broadened.

   A vehicle constitutes a "collective investment scheme" if it falls within the definition of such term as set out in section 235 of the Financial Services and Markets Act 2000. There are certain prescribed exemptions that apply to arrangements that would otherwise constitute collective investment schemes, which are set out in the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001. One such exemption is known as the "group exemption" (in general, an arrangement that would otherwise constitute a collective investment scheme will not constitute a collective investment scheme when all its participants are bodies corporate in the same group; broadly speaking, a "body corporate" is a legal vehicle that has separate legal personality).

4. In its response to the consultation, the BVCA recommended that a UK limited partnership should be able to be designated as a "private fund limited partnership" at any time, so long as the limited partnership satisfies the private fund conditions at the time of designation.

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controls are in place, third-party verification techniques such as penetration testing (a/k/a "hire-a-hacker") can identify security holes, assist in remediation and mitigate risk to bring the firm into line with evolving best practices.

Protect Against Human Error. Even the most secure network can be brought down if employees at all levels aren't sensitized to risks such as "phishing" – that is, well-crafted emails designed to trick recipients into clicking on links, or opening attachments, that result in the installation of malware. Other potential vulnerabilities are less high-tech: the misplaced laptop or thumb drive that contains unencrypted, sensitive data, or the errant email that sends sensitive information to the wrong recipient. By ensuring that employees understand cybersecurity best practices, private equity firms can substantially reduce potential data loss – and avoid the disclosure obligations and other legal burdens that can flow from even an inadvertent, good-faith breach.

Consider Your Vendors. Some highly publicized breaches have involved a hacker accessing a company's systems through an outside vendor. Just as the plumber you let into your office potentially can breach your physical security, so, too, can any vendor that has access to your computer systems, or stores information on your behalf, compromise your cybersecurity.

That means being vigilant both about engaging vendors and managing them on an ongoing basis.

As part of the diligence you undertake when engaging a vendor that has access to your information, consider reviewing the vendor's own security history and practices, including audits and descriptions of security protocols, and asking how the vendor's cybersecurity protocols compare to benchmarks like NIST, SANS or ISO. Questionnaires can be a starting point for the discussions with vendors. At the contracting stage, consider obtaining: an express written commitment to maintain your information securely and to maintain baseline security practices; covenants to provide prompt notification in the event of a breach; indemnification; and a mandate that the vendor carry cyber risk insurance at specified levels. Day to day, consider reviewing the policies and procedures you have in place for issuing credentials (*i.e.*, usernames and passwords) to third parties and your protocols for ongoing monitoring of vendor access to information and security practices. A February 2015 SEC report on cybersecurity at broker-dealers and investment advisers noted that just 24% of these firms imposed requirements relating to cybersecurity risk via their contracts with such parties.

Due Diligence Prospective Portfolio Investments. In this day and age, one important due diligence question is how well an acquisition target safeguards its information and systems from cyberattacks. Specific diligence steps could include, at a minimum, discussions with the company's CIO and a review of critical agreements with vendors providing information technology services.

> "Taking proactive measures to ensure that portfolio companies have robust and tailored cybersecurity protections in place makes good business and legal sense."

Cybersecurity issues also are often addressed in the representations in acquisition agreements. Depending on the diligence findings and the nature of the company's business, the company's practices and approaches to cyber risks could be material to the transaction. As noted above, these and other transaction-specific issues were discussed in the Spring 2015 issues of this publication.

Prepare for a Breach. In addition to analyzing its assets and architecture and implementing control measures such as those discussed above, a private equity firm should develop a plan to respond to a breach incident, should it occur. We will be writing separately in more detail about how best to prepare

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for a breach. In general, regulatory guidance suggests that responsibilities for incident response should be well-defined by senior management of the firm and clear reporting requirements delineated. Answering the following questions can help the firm develop a well-functioning and robust incident response plan:

- What types of business continuity plans are in place in the event of a cyberattack?
- Who are the members of the incident response team, inside and outside the firm?
- Are reporting positions consolidated so that information about breaches can effectively be passed up the chain of command?
- How often does the firm conduct training and how effective is that training?
- What kinds of protections does the firm contractually require third-party vendors to employ to deter cyberattacks?
- What type of insurance coverage for cybersecurity-related events has the firm purchased?

At the Portfolio Company Level

Securing Portfolio Companies. Portfolio companies face most of the same cybersecurity risks discussed above, so private equity firms will want to ensure that their portfolio companies put in place protections of the sort identified above. In addition, portfolio companies also face, and must address, risks specific to their particular businesses. The risk profiles are different for retail businesses that possess credit card numbers and customer contact data; healthcare enterprises that maintain sensitive medical records; and industrial companies that employ business methods so valuable that competitors or even certain nation-states may want to steal them. Taking proactive measures to ensure that portfolio companies have robust and tailored cybersecurity protections in place makes good business and legal sense. The costs of preparation are orders of magnitude smaller than the costs of dealing with intrusions and, more importantly, the potential hit to the value of a portfolio company whose defenses are breached.

Questions for Directors. In the eyes of at least one high-ranking U.S. government official, staying on top of cybersecurity is now a director's legal obligation. In a 2014 speech, outgoing SEC Commissioner Luis Aguilar said cybersecurity "needs to be a critical part of a board of directors' risk oversight responsibilities," and that boards that "ignore, or minimize, the importance of cybersecurity oversight responsibility, do so at their own peril." Among the questions that private equity firm personnel who serve on the boards of portfolio companies might want to ask are the following:

- When was the board last briefed on cybersecurity? Is there a regular schedule for such briefings?
- Who on the board "owns" cybersecurity risk management? For larger boards, is the audit committee or another committee charged with oversight?
- Have there been any prior data security incidents? If so, how were they handled and what was done to learn from them?
- Does the company have an incident response team and plan? If so, does it involve external as well as internal stakeholders? When was the last time it was tested?

Conclusion

Thoughtful preparation can help mitigate cyber risk. Best practices for implementing IT security measures and corporate governance increasingly are converging with emerging legal standards and regulators' expectations. The roadmap to compliance is increasingly clear – and can help both private equity firms and their portfolio companies to reduce their business and legal risk.

This article is the second in a series of articles in The Debevoise & Plimpton Private Equity Report *concerning emerging cybersecurity concerns relevant to private equity firms and their portfolio companies.*

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Building on *Marblegate II*, the *Caesars II* court rejected the argument that the bondholders should be required to show an offensive restructuring of their particular tranche of debt, because such a requirement would ignore the fact that "an impairment may also occur where a company restructures debt arising under *other* notes." It also determined that connected transactions should be reviewed collectively in concluding whether, as a whole, they made up an impermissible out-of-court restructuring. Finally, the court held that impairment must be shown when payment is due under the notes, which is the point at which a noteholder's right can be said to be affected by an issuer's or guarantor's actions.

Practical Implications

While these decisions have been appealed to the Second Circuit, their implications are significant. The facts of these cases are extreme, involving involuntary releases of guarantees and attempts to strip a borrower of assets without requiring the new owner to assume liability for the notes. Nevertheless, the stated rationale of these decisions is extraordinarily broad and could reach transactions involving far less dramatic modifications to noteholder rights. Although the decisions do not clearly define what constitutes a debt restructuring for these purposes, and *Caesars II* indicated that this is a question of fact to be determined on a case-by-case basis, they suggest that any modifications of an indenture – and even automatic guarantee releases and other actions provided for or permitted under an indenture – that actually impair a dissenter's ability to obtain payment are prohibited. Exchange offers, however, commonly involve exit consents whereby exchanging noteholders consent to indenture amendments stripping certain covenants and events of default under typical majority-rule amendment provisions. These alterations of debt terms are designed to discourage noteholders from holding out in order to free ride on concessions made by majority holders. While the *Marblegate I* court stated that exit consents will be permissible in some cases, *Marblegate II* and *Caesars II* call into question the continued viability of this restructuring tool, at least if coupled with other steps such as guarantee releases and transfers of assets out of the reach of dissenting bondholders. In so doing, these decisions may force more companies into bankruptcy or, at a minimum, increase the execution risk and related costs of out-of-court bond restructurings.

In addition, there is anecdotal evidence that these decisions are having an impact on the terms of new bond issuances. Given the breadth of the rationale in these cases and the resulting uncertainty with respect to the feasibility of out-of-court restructurings, issuers have another disincentive to register their bonds with the Securities and Exchange Commission and thereby subject their indentures to the TIA. Further, and unsurprisingly, references to TIA Section 316(b) and any language that approximates that section's text are being meticulously modified or removed from 144A-for-life indentures. Finally, some issuers and their counsel have taken a straightforward step to address the underlying concern of a small holdout minority being able to block a restructuring otherwise supported by a large majority of bondholders: Some recent indentures require only 90% (instead of 100%) support to modify certain fundamental terms like payment obligations and maturity dates. These provisions, modeled on similar provisions commonly seen in the European market, currently represent a minority position in the U.S. market. However, this trend may gain momentum, particularly given that these provisions benefit both issuers and bondholders by removing a holdout's ability to force a consensual financial restructuring into a bankruptcy proceeding that may be lengthy, destroy value and reduce recovery for bondholders (and, ultimately, other constituencies).

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seek to obtain R&W insurance quotes that can be "flipped" to a buyer along with a signal, usually in the auction draft purchase agreement, that the seller will not entertain a traditional indemnity (instead offering to only provide indemnification for up to 0.5%-1% of the purchase price or, in some cases, no indemnity at all). This approach has come to be known as "stapled" R&W insurance. By going out ahead of time to get quotes, the seller signals to bidders that this is not an empty proposal (*i.e.*, insurance is available and the terms, including the cost, are quantifiable for the transaction). In the robust seller's market that we are currently experiencing, this has become an extremely popular way to kick off a sales process and has exposed a number of new parties to the concept of R&W insurance.

Strategic Use

As mentioned above, a positive side effect of the "seller flip" model from a product acceptance vantage point is that it has introduced the concept of R&W insurance to countless strategic buyers who had not come into contact with it previously. R&W insurance has historically been a tool of financial sponsors who were savvy enough to deploy it on the buy-side as a method of arbitrage (*e.g.*, smart buyers could offer a clean exit to a seller at a discounted price, which discount was greater than the cost of an R&W insurance policy). Those same buyers, when seeking to exit the same portfolio companies they had acquired via the use of an R&W policy, would look to use a "seller flip" to prevent that same arbitrage from being imposed upon them. When these financial sellers brought their assets to market, there was very often a strategic acquirer on the other side who was being faced with R&W insurance for the first time. For the strategic acquirer, obtaining their typical 5-20% indemnity/escrow was not in the cards, as any such request in an auction process where R&W insurance was being deployed by other bidders would make them wholly uncompetitive unless their valuation was simply head and shoulders above that of the other bidders. So, many strategic bidders had no choice but to give R&W insurance a try. And the product has really caught on with this contingent. Thus far in 2015, approximately 26% of the insureds under R&W policies placed by Aon have been strategic acquirers and the expectation is that this number will only continue to grow over time. A number of strategic acquirers who had an R&W policy essentially forced upon them have come back on subsequent deals noting how well the product worked and how much smoother the transaction/process went with the insurance in the backdrop.

Industry-Specific Considerations

While the use of R&W insurance has exploded throughout the M&A middle-market, a couple of industries have historically proven difficult to insure. Deals in the financial services industry, for instance, have been challenging if not impossible to insure due to the fact that many of the representations customarily made in transactions in that sector relate to projections and adequacy of reserves, things that are extremely difficult to underwrite.

Similarly, until recently, healthcare transactions, though comprising approximately 20% of all M&A activity, have been a blind spot for the R&W markets because of billing fraud in payor programs (*e.g.*, Medicare and Medicaid). However, that has begun to change. For example, Aon recently announced an exclusive product that is intended to facilitate the procurement of fulsome insurance coverage for breaches of representations & warranties in healthcare deals. By combining the coverage offered by traditional R&W insurance providers with a tack-on policy offering from IronHealth, Ironshore's healthcare division, acquirers of healthcare companies are able to get the full suite of representations & warranties made in healthcare transactions covered by an R&W policy. This should facilitate more transactions in the healthcare space as it will greatly reduce escrow/indemnification requirements, making initial investments and subsequent exits in the space much more attractive, particularly for financial sponsors.

Tax Insurance

In addition to R&W insurance, another type of transaction liability insurance that has grown significantly in popularity over the past year is tax insurance. Like R&W insurance, tax insurance is an effective tool to efficiently structure a transaction in a way that allows a seller to provide a smaller escrow or indemnity cap. For M&A in particular, the real benefit of a tax insurance policy is that it provides certainty and often allows a buyer and seller to move past a

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difficult negotiation over an uncertain issue and close a deal. In M&A, this often arises with respect to an issue discovered during due diligence, such as a prior "tax-free" restructuring or reorganization of a target, a deferred compensation plan's qualification under 409A, or the target's qualification as an S Corp. Tax insurance frequently is used where the parties are reasonably comfortable with the risk, but where there is a disproportionately large tax exposure that may not be resolved for many years. Aon has placed $2.5 billion of insurance in the past 24 months to solve these types of issues and enable transactions to go forward.

Conclusion

Transaction liability insurance has been around for a few decades, but has only recently become recognized as an effective tool that can help get transactions done on better terms for all parties involved. As more and more M&A practitioners deploy these policies in their practice, awareness about these products will rise, further cementing their place in the dealmaking landscape. Aon alone anticipates placing in excess of $10 billion in policy limits globally this year, which indicates broad acceptance of the products and their ability to provide a cost-effective risk transfer solution for M&A transactions. There will undoubtedly be trends that develop with respect to the use of these products, be it new strategies or new products, but there can be no questioning that in some form, these transactional risk tools are here to stay.

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Overview of Suite of Transaction Liability Products

Product	Description | General Price Range	Impact on Negotiations & General Pricing
Representations & Warranties (R&W)	Buyer policy protects the buyer against loss from unknown breaches of R&W including F/S, which are discovered post-close (or post-signing if structured accordingly). The policy can extend the scope/duration of the seller's indemnity. Seller policies provide a backstop to seller indemnification.	Can increase speed of deal execution in light of reduced pressure on risk allocation issues as between buyer and seller (average 10-14 days to quote and put policy in place; can be done more quickly). Favorable impact on auctions. Minimizes escrow/indemnity caps (can be as low as 50 bps of enterprise value). Provides longer term protection than typical seller indemnity (3 years for general reps; 6 years for fundamental and tax reps).
Tax Indemnity	Alternative to Private Letter Ruling (PLR); protects insured from adverse ruling by IRS or relevant taxing authority regarding anticipated tax treatment of a given transaction or issue. Covers tax, interest, penalties, contest costs and gross-up.	Improves execution by bridging the discount a buyer may put on an issue relative to the seller's analysis. Can cover 338(h)(10) elections, NOLs, 355(e), transfer pricing, sale of REIT shares, real estate issues, cross border issues, etc. No tax opinion needed, though helpful to have; Reduces time and can reduce cost.
Litigation/Contingent Liability/ Fraudulent Conveyance	Provides certainty via a "box" or "ring fence" around existing or likely litigation to protect insured against catastrophic loss that exceeds the expected loss amount.	Improves execution by bridging the discount a buyer may put on an issue relative to the seller's analysis. Can function as "signaling capital" by showing adversarial parties objective view of risk.

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need to make it of general application means that many of the definitions are more generic and therefore catch more people. For example, FATCA is based on taxation on the basis of citizenship whereas the CRS is based on residence. The fact that residence is sometimes a nebulous concept leaves scope for residence to be interpreted broadly; for example, one of the indicia regarding residence is where an account holder has its telephone number.

There is some unhelpful guidance from the OECD that suggests that a "senior managing official" in a passive NFE may count as a controlling person and therefore need to be disclosed. This is very different from FATCA, which looks only to beneficial owners, and could mean that the disclosure requirements under CRS far outstrip those under FATCA. Exactly how this guidance will play out in practice is unclear but we are aware of some entities taking it at face value.

7. If I am based in the US (or another non-participating country) can I ignore CRS?

No. The CRS treats investment entities in non-participating jurisdictions as passive NFEs and therefore requires that any financial institution in a participating country look through such entity to its controlling persons. As noted above, this class of reportable person has the potential to be very broad.

8. Is this the end of FATCA and UK FATCA?

FATCA will remain in the post-CRS world. The UK implementation of CRS will replace UK FATCA as of 1 January, 2016.

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Russia Transforms the Legal Landscape for Private Equity Deals

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entered into by the company in breach of its charter. This is in contrast to the previous regulations where a director could not meaningfully assist shareholders enforcing actions in the event of a corporate conflict.

Matters Affecting Due Diligence Review of Russian Companies

Shareholders' Registers to Be Held by Independent Registrars

Until recently, joint stock companies having fewer than 50 shareholders were allowed to hold and keep their shareholders' registers themselves. Share registers of all joint stock companies, whether private or public, must now be held by licensed registrars, which should provide additional comfort to investors confirming title to shares.

Principles of State Registration of Rights to Property

The Civil Code now contains the basic principles of state registration of rights to property where such registration is required by law, which would cover, for example, rights to real estate, intellectual property rights and rights to participatory interests in a limited liability company. Recently introduced provisions are aimed at promoting a presumption of public accuracy of state registers while also permitting notices of objection and challenge to be entered on the register. These changes are intended to ensure that any party conducting a due diligence review of a Russian company will be able to rely on the information contained in public registers.

This summary does not cover all of the recent amendments to Russian corporate and civil law, but highlights some matters of interest to private equity investors. It is also important to note that Russian law continues to undergo significant changes, and it is therefore important to monitor future amendments.

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partnership incurred while it takes part in the management. However, there is no authoritative guidance on what taking part in the management of the partnership business means. As a result, there is a degree of uncertainty as to what a limited partner of a UK limited partnership may do without jeopardising its limited liability status.

The white list does not seek to prescribe what rights the limited partners in a private fund will have. Instead, the white list will enable the general partner and limited partners of a private fund limited partnership to give effect to their commercial agreement on what governance, review and oversight rights the limited partners should have, with the added

"The consultation proposes abolishing: *(i)* the requirement for a limited partner of a private fund limited partnership to contribute capital to that limited partnership; and *(ii)* the restriction on a limited partner of a private fund limited partnership withdrawing capital contributed to that limited partnership during the life of that limited partnership."

The consultation proposes introducing a "white list" of activities that a limited partner of a private fund limited partnership may perform without jeopardising its limited liability status.[5] The list itself is drafted broadly and covers activities such as approving or vetoing investments, as well as more mundane limited partner governance matters (*e.g.*, approving financial accounts, appointing a person to represent the limited partner on the private fund's advisory committee and taking part in a decision in respect of a potential or actual conflict of interest).

certainty that the limited partners may undertake activities that fall within the categories of activities set out in the white list without jeopardising their limited liability status.

Abolition of the Two Rules on Capital

Currently, a limited partner of a UK limited partnership must contribute capital on its admission as a limited partner in order to secure its limited liability status (*i.e.*, capital must be drawn down from, or advanced on behalf of, an investor concurrently with its admission as a limited partner). Further, a limited partner of a UK limited partnership that withdraws capital contributed to that limited partnership during the life of that limited partnership will be liable for the debts of that limited partnership up to the amount of capital withdrawn.

As a consequence of these two rules on capital, a convoluted and overly prescriptive approach has developed in respect of the admission of a limited partner to a UK limited partnership and the distributions made to a limited partner during the life of that limited partnership.

Currently, it is typical for an investor in a private fund formed as a UK limited partnership to have its total funding commitment split between a nominal capital contribution and a contractual undertaking to fund the balance of its commitment by way of interest-free loans or advances. The primary reason for the capital/loan split is to enable an investor to receive distributions from a private fund formed as a UK limited partnership in respect of its commitment prior to the end of the life of that limited partnership without being subject to a statutory obligation to return such distributions. This split often results in complications, as well as confusion for those unfamiliar with UK limited partnership law.

The consultation proposes abolishing:

(i) the requirement for a limited partner of a private fund limited partnership to contribute capital to that limited partnership; and

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5. Adoption of the "white list" will bring the "private fund limited partnership" in line with limited partnerships established in Delaware, the Cayman Islands, the Channel Islands and Luxembourg.

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(ii) the restriction on a limited partner of a private fund limited partnership withdrawing capital contributed to that limited partnership during the life of that limited partnership.

The abolition of the two rules will allow a limited partner of a private fund limited partnership to fund the full amount of its commitment to that limited partnership by way of capital contributions only, while also allowing the flexibility for a private fund sponsor to continue to employ the traditional capital/loan split for a private fund limited partnership if it wishes.

Introduction of a More Streamlined Approach to Publicly Available Information

The existing registration process in respect of UK limited partnerships is complicated insofar as it requires certain information about a limited partnership's status to be registered, namely: (*i*) the general nature of the limited partnership's business and (*ii*) the term of the limited partnership. This information forms part of a publicly accessible register that is maintained by Companies House.[6]

The consultation proposes a simplified registration process for private fund limited partnerships, with a reduction in the amount of information that has to be included in an application for registration when compared with what is currently required for a UK limited partnership. For example, the amount of a limited partner's capital contribution would no longer have to be notified to Companies House. This proposal would also reduce the amount of information about a private fund limited partnership that is made available to the public.[7]

In addition, the consultation proposes abolishing the requirement to advertise publicly certain changes to a private fund limited partnership. Currently, an advertisement must be placed in the London Gazette if, for example, a limited partner of an English limited partnership assigns any portion of its interest in that limited partnership to another person.

Next Steps

The consultation period ended on 5 October 2015.

If HM Treasury decides to take forward any reforms, the reforms will be enacted by way of a legislative reform order.[8] Based on correspondence with HM Treasury, it is expected that the final legislative reform order will be put before the UK parliament early in 2016.

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6. Companies House incorporates and dissolves UK companies and limited liability partnerships and registers UK limited partnerships, registers the information they are legally required to supply and makes that information available to the public.

7. The name of each limited partner of a UK limited partnership is publicly accessible information. The consultation does not propose to alter this position. A number of respondents to the consultation recommended that this requirement be abolished.

8. A legislative reform order is a statutory instrument that can amend primary legislation (such as the 1907 Act) without the need to follow the full parliamentary process for primary legislation. A minister of the UK Government may make a legislative reform order for the purpose of removing or reducing any burden to which any person is subject as a result of any legislation.

Recent and Forthcoming Events

February 22-23
Legal Agreements in Private Equity
David Innes
BVCA Legal Agreements Course
BVCA
London

January 21
Legal Strategies: Protecting GP Interests and Maintaining Competitive and Marketable Positioning to LPs
Andrew M. Ostrognai
Fundraising Masterclass
EMPEA
Hong Kong

December 10
Defending Corporations and Individuals in Government Investigations
Mark P. Goodman
Sean Hecker
Jim Pastore
Thomson Reuters
White Collar Conference
Debevoise & Plimpton LLP
and Thomson Reuters
New York

December 7
Driving the Deal Through: Navigating the Brazilian Regulatory Environment
Peter A. Furci
Matthew W. Howard
7th Annual Private Equity
Brazil Forum
Markets Group
São Paulo

December 4
A New Weapon in Mega-Bankruptcy Cases: The Trust Indenture Act
My Chi To
Winter Leadership Conference
American Bankruptcy Institute
Phoenix, Arizona

December 3
Mid-Cap Bank Roundtable with Ernst & Young, Houlihan Lokey
Gregory J. Lyons
Debevoise Seminar
Debevoise & Plimpton LLP
New York

December 2
"New Economy" Company Regulatory Challenges
Jim Pastore
PLI's Advanced Venture Capital 2015
Practising Law Institute
San Francisco

December 1
The Landscape of Private Equity Fund Formation
Sally Gibson
Private Equity and Venture
Capital in the Nordics
BVCA
London

November 30
Legal Strategies: Balancing GP Interests and Maintaining Competitive and Marketable Positioning to LPs
Geoffrey P. Burgess
Geoffrey Kittredge
Andrew M. Ostrognai
Fundraising Masterclass
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November 24
Legal Considerations: Structuring, Key Terms & LPA Negotiation
Geoffrey Kittredge
Investor Relations Training Course
BVCA
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November 20
Every Man for Himself in Private Equity?
Erica Berthou
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Fund Focus 2015
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November 18
AML/Sanctions Regulation and Enforcement Climate: Updates and Observations
Satish M. Kini
The Clearing House Annual
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The Clearing House
New York

November 17
African Insurance M&A: Global Issuers' Next Frontier
Geoffrey P. Burgess *(moderator)*
David Grosgold
Andrew M. Levine
Matthew Howard Getz
Benjamin Lyon
Debevoise Roundtable Discussion
Debevoise & Plimpton LLP
London, New York

November 17
Coping with Regulatory Change: What's Next in IA Compliance Cybersecurity: Best Practices for an Effective Defense
Kenneth J. Berman
IA Watch and Buyouts Insider
Washington, D.C.

November 13
Developments in Electronic Media Regulation; Developments in Intellectual Property Law; Hot Issues in Social Media
Jeffrey P. Cunard
Communications Law
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November 12
Russian Civil Code Reforms: New Rules for M&A Transactions
Alan V. Kartashkin
7th Annual Mergers & Acquisitions in Russia and CIS Conference
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Deal Structuring and Execution
Paul S. Bird
Private Equity Symposium
International Bar Association
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November 12
The Evolution of Fund Formation
Geoffrey Kittredge
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Breakfast Seminar
BVCA
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November 11
When the UK Became a Tax Haven (Except for Fund Managers) and Why This Matters to US Sponsors
Matthew D. Saronson
Richard Ward
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Ceinwen Rees
Debevoise Seminar
Debevoise & Plimpton LLP
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November 10
Strategic Perspective of China and Pan-Asian Insurance Leaders
E. Drew Dutton
InsuranceCom Asia Management Conference
Uvision
Hong Kong

November 10
Senior Executive Panel Discussion: Strategic Perspectives of Asian Leaders
E. Drew Dutton
Insurers in Asia – Winning Strategies in the Digital Age
InsuranceCom
Hong Kong

November 9
Private Equity Investing in Africa
Geoffrey P. Burgess
Private Equity in Africa
Columbia Business School
New York

November 4-5
"Going All-In"– Managing a True Corporate Crisis, Internal Investigation and Enforcement/Prosecution
Jonathan R. Tuttle
Securities Enforcement Forum 2015
Securities Docket
Washington, D.C.

October 27
Volcker Rule Roundtable with RMA
Gregory J. Lyons
Debevoise Seminar
Debevoise & Plimpton LLP
New York

October 27
Persistence, Performance and Returns
Geoffrey P. Burgess
Private Equity in Emerging Markets 2015
EMPEA and The Financial Times
London

October 15
The New Dawn of Cybersecurity and Related Risks
David A. O'Neil
3rd Annual Anti-Corruption and Investigations Conference
Latin Lawyer and Global Investigations Review
São Paulo

October 8
Regulation, Financing Markets and Debt Financing
Pierre Maugüé
2015 Summit
BVCA
London

October 8
Secondaries, Fund Extensions and Restructurings
Katherine Ashton
2015 Summit
BVCA
London

October 7
Alternatives to Bankruptcy
M. Natasha Labovitz
27th Annual Conference
Turnaround Management Association
Scottsdale, Arizona

October 5
Heading for the Exit: Trends in IPOs and Dual Track M&A Processes
Paul M. Rodel
Securities Law Committee Seminar
International Bar Association
Vienna

Recent Client Updates

Listed below are Debevoise & Plimpton Client Updates and publications since our last issue of this publication that are most relevant to the private equity industry. They can be found at www.debevoise.com.

November 9, 2015
New Federal Guidance on Cybersecurity for Mobile Devices
Jeremy Feigelson
Jim Pastore
Jeewon Kim Serrato
Jonathan Metallo

November 3, 2015
Bipartisan Budget Act of 2015 Revamps Partnership Tax Audit and Collection Procedures
Adele M. Karig
Vadim Mahmoudov
Matthew D. Saronson
Peter F. G. Schuur
Rafael Kariyev

October 14, 2015
U.S. Further Relaxes Cuba Sanctions
Satish M. Kini
Carl Micarelli
Robert T. Dura

October 13, 2015
No Coverage Under General Liability Policies in Recent Data Privacy Suits
Jeremy Feigelson
Andrew M. Levine
Jeewon Kim Serrato
Keith J. Slattery
Sisi Wu

October 9, 2015
Significant New International Capital Requirements Announced for Global Insurers, with Potential Impact on M&A Activity
Eric R. Dinallo
E. Drew Dutton
Jeremy G. Hill
Ethan T. James
Thomas M. Kelly
Gregory J. Lyons
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James C. Scoville
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Stuart J. Valentine
Peter Wand
Edite Ligere
Benjamin Lyon
Samuel E. Proctor

October 6, 2015
Transfers of Personal Data to the United States: European Court of Justice Rules the Safe Harbour Protocol Is Potentially Invalid
Thomas Schurrle
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Matthew Howard Getz
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October 6, 2015
Uncertainty Over UK Taxation of Delaware LLCs: UK Tax Authority's Finesse
Richard Ward
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October 5, 2015
In Two Recent Orders, CFTC Holds that Bitcoins Are Commodities
Byungkwon Lim
Emilie T. Hsu
Peter Chen
Aaron J. Levy

September 28, 2015
The OECD's Automatic Exchange of Information Common Reporting Standard
Richard Ward
Matt Saronson
Cecile Beurrier
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September 24, 2015
SEC Sanctions Investment Adviser for Failing to Adopt Cybersecurity Policies and Procedures
Jeremy Feigelson
Michael P. Harrell
Jim Pastore
David Sarratt
Derek Wikstrom
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September 23, 2015
SEC Enforcement Actions Getting Up Close and Personal
Matthew E. Kaplan
Alan H. Paley
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September 18, 2015
SEC Releases Updated Cybersecurity Examination Guidelines
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September 15, 2015
The "Yates Memorandum": Has DOJ Really Changed Its Approach to White Collar Criminal Investigations and Individual Prosecutions?
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September 14, 2015
Organisations Carrying on Business in the United Kingdom Must Now Publish Annual "Slavery and Human Trafficking Statement"
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James C. Scoville
Nicola Leslie
Thomas Matthews

August 31, 2015
FinCEN Proposes Anti-Money Laundering Rules for Investment Advisers
Kenneth J. Berman
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August 28, 2015
In re Dole Food Co.: When Stockholders Deserve a Fairer Price
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Gary W. Kubek
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William D. Regner

August 25, 2015
Court Upholds FTC Cyber Authority; Recent FTC Guidance on Insider Breaches Looms Larger
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August 17, 2015
Cyber Crime Gets Back to Basics: How Cyber Criminals Are Monetizing Stolen Information through Well-Worn Criminal Strategies
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OFAC Updates Russia and Ukraine Sanctions Lists, Issues Advisory on Evasion of Crimea Embargo
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August 3, 2015
U.S. Fund Managers – The Latest AIFMD News
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August 2015
Breach Reading: A Midyear Review of Cybersecurity & Data Privacy
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July 29, 2015
Treasury Issues Proposed Regulations on Management Fee "Waiver" Mechanisms
Michael Bolotin
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July 28, 2015
Data Breach Plaintiffs' Suit Reinstated; Court Holds Affected Customers Have Standing
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July 26, 2015
Consultation on UK Limited Partnership Law Reform for Private Investment Funds
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July 9, 2015
SEC Pay-to-Play Placement Agent Restriction Delayed and a Reminder for Campaign Season
Kenneth J. Berman
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July 8, 2015
The UK Becomes a Tax Haven. (Unless You're An Asset Manager)
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July 6, 2015
The Delaware LLC: Now We See It, Now We Don't…or Do We?
Richard Ward
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