ICLG

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Private Equity 2017

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1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions? Have you seen any changes in the types of private equity transactions being implemented in the last two to three years?

Trends in the private equity market in Bermuda tend to track the markets in the major onshore jurisdictions, particularly in the USA, Europe and Asia.

Political uncertainty in both the US and Europe may bring challenges for the private equity sector, as the impact of Brexit in Europe and the proposals for tax reform in the US are a focus of investors and sponsors on both sides of the Atlantic. However, proposals for increased investment in infrastructure in the US signal opportunities for Bermuda in terms of structuring private equity investments, including, in particular, the first new corporate vehicle introduced in Bermuda in over 100 years, the limited liability company ("LLC"), which is based on the Delaware model.

1.2 What are the most significant factors or developments encouraging or inhibiting private equity transactions in your jurisdiction?

Bermuda continues to offer a broad array of venture capital and private equity opportunities and is very attractive to investors due to the safe, well-regulated, business-oriented environment and the deep bench of industry and professional expertise available locally. Bermuda has been an OECD 'whitelist' country since 2009 and has robust anti-money laundering regulations.

The Bermuda Monetary Authority ("BMA"), which is responsible for regulating the financial services sector in Bermuda, takes a risk-based approach to the regulation and supervision of the entities for which it is responsible. Closed-ended private equity funds do not fall within the definition of an 'investment fund' under the Investment Funds Act, 2006 and are not regulated for the purpose of that Act being subject only to the basic legal requirements applicable to the particular private equity vehicle used.

The BMA actively engages the private sector and industry specialists in respect of any proposed legislative change. Recent legislative changes which have arisen as a result of a collaboration between the BMA, the Bermuda Government and the private sector, have enhanced the choices available to companies looking to structure a private equity deal or fund in Bermuda. These amendments (which are detailed further in the response to question 10.1 below) modernise Bermuda's asset management sector and improve its product offering for both private equity and closed-ended investment funds.

The BMA is positioning Bermuda to receive a recommendation by the European Securities and Markets Authority to enable Bermuda to operate as an Alternative Investment Fund Managers Directive equivalent jurisdiction, which would allow Bermuda fund managers to opt in to the AIFMD Passport regime once it is extended to third countries. Once granted, it is anticipated that the availability of this regime will stimulate deal activity.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction? Have new structures increasingly developed (e.g. minority investments)?

Private equity acquisition structures vary widely and may involve majority or minority investments or M&A transactions. Acquisition structures involving private Bermuda companies may involve direct investment into the target company (by the issue of new shares to the private equity investor, or by secondary issues) or the formation of a holding company ("Topco") into which the private equity investor will invest alongside management and other shareholders. Intermediate holding companies between Topco and the ultimate target may be inserted to facilitate debt financing, security structures or for tax or other commercial reasons. If so, the relevant holding company would acquire the shares in the target company typically by way of a share purchase, share for share exchange or by a merger or amalgamation with the target company (although other acquisition structures may be used including those mentioned below).

For acquisition structures involving public companies, these are typically structured by way of one or more of the following:

- a general offer to purchase the shares (or class of shares) of the target, which must generally be accepted by the holders of at least 90% of the shares that are the subject of the offer to enable the offeror to compulsorily acquire the remaining shares;
- compulsory acquisition of the shares of the remaining shareholders where the acquirer obtains 95% or more of the shares;
- a court sanctioned scheme of arrangement pursuant to section 99 of the Companies Act, 1981 (as amended) (the "Companies Act"). A scheme requires board approval (as the board typically proposes and controls the scheme process) and the approval of a majority in number of scheme shareholders (or

classes thereof) representing three-fourths in nominal value voting at the special general meeting convened by the court to approve the scheme; and

- amalgamations or mergers pursuant to the Companies Act. An amalgamation involves two or more companies amalgamating and continuing as one company and a merger involves one company merging into another with only one company surviving. The board of the amalgamating or merging companies would approve the terms of the amalgamation or merger (including an implementation or similar transaction agreement) and the statutory amalgamation or merger agreement (as applicable), which would be subject to the approval of the shareholders of each of the amalgamating or merging companies. Subject to the bye-laws, the approval of 75% of the shareholders present and voting at a special general meeting at which two or more persons are present in person or by proxy is required. All shareholders of a company (even those holding non-voting shares) are entitled to vote on an amalgamation or merger. Dissenting shareholders have the right to apply to the court to have the fair value of their shares appraised by the court within one month of the notice convening the meeting.

2.2 What are the main drivers for these acquisition structures?

The structure will depend on the nature of the proposed acquisition and the nature of the target (public/private) as well as tax, commercial and regulatory considerations.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

Structures vary widely but will often involve the private equity investors taking ordinary shares, preference shares and/or loan notes. Management would usually hold ordinary shares and/or employee share options or restricted shares. Carried interests are less common.

2.4 What are the main drivers for these equity structures?

This will largely be determined by the location of the private equity investor and tax and commercial requirements for the structuring of investments and any debt related financing.

2.5 In relation to management equity, what are the typical vesting and compulsory acquisition provisions?

Management shares or options would typically be subject to compulsory acquisition provisions which normally include 'good leaver/bad leaver' provisions. Depending on the bargaining strength of the parties, either good or bad leaver would usually be defined, with all other circumstances being deemed to be good or bad, as the case may be. Typical good leaver provisions include death, disability or long-term illness or after a certain length of employment (effectively vesting the value of the shares after an agreed period). Typically a good leaver would receive the higher of cost and fair value for his shares and a bad leaver can expect to receive the lower of fair value and cost.

2.6 If a private equity investor is taking a minority position, are there different structuring considerations?

Considerations would include: pre-emption rights (protecting against dilution) on new issues as well as share transfers; drag/tag-along rights; and other change of control provisions. The investor would usually seek veto rights over certain matters, including any changes to the share capital, debt position, constitutional documents and a change of control of the company or of the nature of the business conducted by it.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

A Bermuda-domiciled private equity portfolio company would be managed by a board of directors including executive directors, investor directors and independent directors. The composition of boards of portfolio companies varies widely depending on the deal structure.

The board's authority is derived from the shareholders and is subject to any restrictions set out in the constitutional documents and in any shareholders' agreement.

The constitutional documents comprise the memorandum of association, which sets out the objects and powers of the company and the bye-laws which govern the relationship between the company and its shareholders and contain the corporate governance provisions. The memorandum of association is filed at the Registrar of Companies in Bermuda and is publicly available.

The bye-laws may also be subject to a separate shareholders' or investor rights agreement between the company and its shareholders (or some of them), which are often required by private equity investors, in part due to concerns over confidentiality. However, neither the bye-laws or any shareholders' or investor rights agreement are required to be filed or registered in Bermuda.

3.2 Do private equity investors and/or their director nominees typically enjoy significant veto rights over major corporate actions (such as acquisitions and disposals, litigation, indebtedness, changing the nature of the business, business plans and strategy, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

Yes. See the response to question 2.6 above.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

(i) Generally veto rights would be upheld by the Bermuda courts unless they were considered to be an unlawful fetter on the statutory powers of the company. The Companies Act expressly permits a company to fetter its powers in certain circumstances, including changes to the constitutional documents, changes to share capital, removal of directors, approval of amalgamations and mergers and voluntary liquidations.

(ii) An investor or nominee director is subject to overriding fiduciary and statutory duties which are owed to the company and its shareholders as a whole and would need to ensure that at all times decisions were being made with a view to the best interests of the company.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

A private equity investor would not generally owe any fiduciary or other duties to a minority shareholder (unless it had agreed to assume them). The shareholders' agreement will commonly contain provisions that expressly exclude any such duties on the part of the investor.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

(i) Shareholder agreements that are subject to a governing law other than the laws of Bermuda would generally be enforceable in Bermuda (provided they do not contravene statute or public policy). Third-party rights may now be conferred by contractual provisions but not by a company's bye-laws and any such provisions should be set forth in the shareholders' agreement.

(ii) Non-compete and non-solicitation provisions would be upheld to the extent that they are necessary to protect the legitimate business interests of the private equity investor.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies under corporate law and also more generally under other applicable laws (see section 10 below)?

(i) Directors of Bermuda companies owe their duties generally to the company itself and not to the party that nominated them. Nominee directors need to be particularly mindful of their duties to act in the best interests of the company and to avoid conflicts of interests.

(ii) Although the concept of a 'shadow director' is not formally recognised in Bermuda, for the purposes of section 243 of the Companies Act (dealing with offences by past or present officers of companies in liquidation), the definition of 'officer' includes a person 'in accordance with whose directions or instructions the directors of a company have been accustomed to act'.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Directors would be required to comply with provisions of the Companies Act and the bye-laws in relation to any conflicts arising.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including competition and other regulatory approval requirements, disclosure obligations and financing issues?

Timetables are usually dictated by any regulatory approvals required in the jurisdictions in which the private equity investor or the target's assets is located. There are no competition or anti-trust filings in Bermuda. Entities that are regulated by the BMA would need to observe regulatory notification requirements and obtain any necessary BMA consents.

All issues or transfers of shares in Bermuda companies require the prior permission of the BMA, unless a general permission has been granted. A general permission is available for the issue or transfer of shares in a company whose shares are listed on a recognised stock exchange. The BMA will require disclosure of the intermediate and ultimate beneficial ownership of any person wishing to acquire more than 10% of a Bermuda company. Beneficial ownership of private equity funds that are limited partnerships would be traced through the general partners not the limited partners.

Public offers of shares of a Bermuda company may require a prospectus to be published and filed in Bermuda unless an exemption is available.

4.2 Have there been any discernible trends in transaction terms over recent years?

Trends in transaction terms tend to follow the trends in whatever jurisdiction the private equity investor and/or the target company is located.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

Bermuda does not have a Takeover Code. The principal regulations governing take- privates involving Bermuda companies are derived from:

- the Companies Act, 1981 and other applicable legislation;
- if the shares of the target entity are listed on the Bermuda Stock Exchange ("BSX"), the BSX Listing Regulations;
- if the shares of the target entity are listed and/or traded on a foreign stock exchange, the Takeover Code and applicable Listing Rules and regulations concerning disclosure, insider dealing and market manipulation in the relevant jurisdiction; and
- the constitutional documents (namely, the memorandum of association and bye-laws).

See also the response to question 2.1 for structuring considerations.

5.2 Are break-up fees available in your jurisdiction in relation to public acquisitions? If not, what other arrangements are available, e.g. to cover aborted deal costs? If so, are such arrangements frequently agreed and what is the general range of such break-up fees?

Break fees are permitted in Bermuda on the basis that they provide

compensation for losses incurred during the course of negotiating the failed transaction (and do not constitute a penalty), and are usually between 2–4%. Other common provisions are exclusivity, 'no shop' and 'go shop'.

Boards of Bermuda companies need to be cognisant of statutory and common law duties applicable to directors, including to act honestly and in good faith in the best interests of the company. It is common for directors to seek 'fiduciary out' clauses (particularly with respect to 'no shop' restrictions and exclusivity undertakings).

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

Common consideration structures involve working capital or debt free/cash free adjustments and earn-outs on the buy-side. Escrow and holdback provisions are routinely included in support of any consideration adjustment mechanisms, as well as in respect of claims under the warranties and indemnities. On the sell-side, investors often seek to limit the amount of any such claims to the escrow/holdback funds.

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

Private equity investors typically only give warranties as to title to shares, capacity and authority. Such warranties are usually unlimited in time and amount although that will be subject to negotiation.

Management usually provide the business warranties and any indemnities. Warranties may be provided generally on an indemnity basis but more usually we would expect warranties to give rise to claims in damages only and specific indemnities to cover only known issues arising through the due diligence/disclosure process.

Limitations on the warranties and indemnities would usually be heavily negotiated and would include time limits (typically one to three years) and limits on amounts as well as individual and aggregate basket provisions.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Typically, only exiting management would provide restrictive covenants, the scope of which should only extend to what is necessary to protect the legitimate business interests of the buyer.

6.4 Is warranty and indemnity insurance used to "bridge the gap" where only limited warranties are given by the private equity seller and is it common for this to be offered by private equity sellers as part of the sales process? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such warranty and indemnity insurance policies?

Insurance is available and attractive to private equity sellers looking to 'bridge the gap', but our experience has been that its use can be limited depending on the nature of carve-outs and policy limits (of which there is a wide range) and the scope of coverage. Insurers would typically require all other recovery sources (e.g. escrow and holdback funds) to be exhausted before recovering under any such policies.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

See the answer to question 6.2 above.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

See the answer to question 6.1 above. On the buy-side, it is common for parent guarantees to be sought from corporate sellers (less so from management unless it is a secondary buyout).

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain if commitments to, or obtained by, an SPV are not complied with (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Comfort is typically provided in the form of a comfort letter upon which the target company can rely, which would be subject to satisfaction of all deal conditions including debt/equity financing availability.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are permissible and are seen but are not very common.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

IPOs are a very common exit strategy in Bermuda. During the first three-quarters of 2015, private equity exits totalled $19.68 billion. Challenges would usually arise due to the regulatory rules and market conditions in the jurisdiction in which the IPO is being launched. IPOs on the BSX would require compliance with the BSX Listing Regulations.

Any Bermuda company offering shares to the public would need to comply with the prospectus requirements of the Companies Act. Where the company is seeking a listing on an appointed stock exchange other than the BSX and a prospectus has been submitted to the relevant stock exchange, it is not also necessary to publish and file a prospectus in Bermuda.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

This would depend on the rules of the relevant stock exchange.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Private equity sellers increasingly pursue more than one exit strategy simultaneously, including IPOs, trade sales and/or secondary buyouts, with a view to achieving the most favourable outcome in the circumstances. The timing and ultimate realisation of such processes will be dictated by the available routes to exit.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

The most common source is term loan or revolving credit financing from a traditional bank (which may or may not incorporate a junior or mezzanine layer). Increasingly, deal structures may involve alternative financing arrangements from funds and other institutional investors. High yield bond financing transactions are very popular, especially in Bermuda companies that are listed in Asia.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

There are no such requirements or restrictions arising under Bermuda law.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

Non-Bermuda residents are not subject to any profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax in Bermuda. Private equity vehicles and portfolio companies that are Bermuda exempted companies, partnerships or LLCs, may obtain a tax assurance from the Minister of Finance for a nominal fee confirming that, until 31 March 2035, in the event that legislation is enacted in Bermuda that would impose such taxes, it will not apply to the entity concerned or its operations, shares, interests, debentures or obligations.

9.2 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

Please see the answer to question 9.1 above.

9.3 What are the key tax-efficient arrangements that are typically considered by management teams in private equity portfolio companies (such as growth shares, deferred / vesting arrangements, "entrepreneurs' relief" or "employee shareholder status" in the UK)?

Please see the answer to question 9.1 above.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

Please see the answer to question 9.1 above.

10 Legal and Regulatory Matters

10.1 What are the key laws and regulations affecting private equity investors and transactions in your jurisdiction, including those that impact private equity transactions differently to other types of transaction?

Recent legislative changes have significantly enhanced Bermuda's product offering in relation to private equity investments. The following three are the most commonly used vehicles for structuring investment funds and private equity investments in portfolio companies:

(i) **Exempted limited partnerships** commonly used for investment funds and subject to the Exempted Partnership Act, 1995 and the Limited Partnership Act, 1883. A Bermuda partnership may elect to have separate personality and the general partner is not required to be Bermuda resident. Limited partnership agreements can be customised from Delaware models easily and are flexible. While limited partners must not take part in management, the 'safe harbour' provisions (which will not constitute management by a limited partner) have recently been extended and include nominating and serving on management boards. Limited partners do not owe any fiduciary duties to any other partner or the partnership itself.

(ii) **Exempted companies** are governed by the Companies Act. Exempted companies are companies limited by shares and shareholders' liability is limited to the amounts unpaid on their shares. Exempted companies can create a registered segregated accounts structure under the Segregated Accounts Act, 2000 (whereby each segregated account is not liable for the debts and obligations of the other segregated accounts), which is particularly beneficial to deal-by-deal and hybrid investment strategies.

(iii) **LLCs** introduced by The Limited Liability Company Act and based on the Delaware model. The LLC is a hybrid between a limited partnership and a company and offer a great deal of flexibility to investors. LLCs are a separate legal entity and may be managed by members, and the operating agreement allows for maximum contractual flexibility and may expressly exclude fiduciary duties owed to the members or the partnership. LLCs may convert to companies or partnerships and *vice versa*.

10.2 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

The BMA is currently engaged in a consultation process with respect to proposed improvements to the Investment Funds Act, 2006 and the Investment Business Act, 2003. Legislation permitting the incorporation of segregated accounts is also anticipated.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope etc.)? Do private equity investors engage outside counsel / professionals to conduct all legal / compliance due diligence or is any conducted in-house?

Bermuda counsel would typically be engaged to review the corporate structure, regulatory compliance and annual filings as well as to confirm that there is no outstanding litigation or registered charges in Bermuda. Typically, the assets of a Bermuda company would be located outside of the jurisdiction. We are often involved in cross-border legal due diligence projects.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Bermuda has recently passed the Bribery Act, 2016 which creates new offences of bribery, including offences committed by associated persons (including directors, officers, employees) for which a commercial undertaking may be held liable. As this is recent, its impact on transactions has not been greatly felt. However, transaction documents will need to include contractual protections for potential liability under this Act.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

The liability of a shareholder in a Bermuda company limited by shares is limited to the unpaid amounts (if any) in respect of their shares. This is the corollary to the principle of separate corporate personality established in *Salomon v A Salomon & Co Ltd* [1897] AC 22.

As a consequence, a company's actions are its own for which it is responsible. A company's liability is also its own and does not pass through to its shareholders. The circumstances in which the court will ignore the principle of a company's separate liability and hold the shareholders accountable for a company's actions (known as '*piercing the corporate veil*') are therefore very exceptional. Such cases would generally involve the legal personality of the company being used for the purpose of wrongdoing where no other remedy is available.

Under section 246 of the Companies Act, if during the course of the winding up of a company it appears that any business of the company has been carried on with the intention to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, any person who was knowingly a party to the carrying on of the business in such manner may be held personally liable without any limitation of liability, for all or any of the debts or other liabilities of a company. See also the response to question 3.6 above.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

If a foreign private equity investor is seeking a physical presence in Bermuda, the Bermuda Business Development Agency (www.bda.com) offers information and support in the form of a 'concierge service' and will assist with making the appropriate connections in terms of the regulators and service providers in Bermuda.

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Natalie has over 18 years' experience advising on a range of corporate and regulatory matters including corporate governance issues; IPOs; banking and private equity transactions; mergers and acquisitions (with particular expertise in regulated entities); joint venture and special purpose vehicles; and offshore corporate, partnership and limited liability company structures (with particular expertise in relation to complex global restructuring projects involving Bermuda entities).

Natalie is a certified director of the Institute of Directors and is Executive Committee Member and Chairman of the Regulatory Sub-Committee of the Institute of Directors – Bermuda Branch.

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