



Private Equity

Fund formation and transactions
in 42 jurisdictions worldwide

2009

Contributing editor: Casey Cogut



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Jersey

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Formation and terms operation

1 Forms of vehicle

What legal form of vehicle is typically used for leveraged buyout (LBO) funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The typical LBO fund in Jersey will be a limited partnership established under Jersey law and registered with the Registrar of Limited Partnerships in Jersey in accordance with the provisions of the Limited Partnerships (Jersey) Law 1994. Under current law a limited partnership does not have separate legal personality. However, legislation is proposed and likely to come in to force during 2009 whereby a limited partnership can be established as: an unincorporated partnership with no separate legal personality (an unincorporated limited partnership), or an incorporated partnership, which would have its own legal personality (an incorporated limited partnership), or an unincorporated partnership with separate legal personality (a separate limited partnership).

In each case the investors will have limited liability unless they participate in the management of the partnership. Under the current model the general partner will have unlimited liability for all of the debts and obligations of the partnership. Similarly, for an incorporated limited partnership and a separate limited partnership, the general partner will have unlimited liability for all of debts and obligations of the partnership.

Typically, the manager would be contracted to provide its services by the general partner and its relationship with the partnership will be defined by the terms of that contract.

2 Forming an LBO fund vehicle

What is the process for forming an LBO fund vehicle in your jurisdiction?

A partnership is formed by agreement and will come into being upon the execution of that agreement. The limited liability benefits of a limited partnership are not obtained until the partnership is registered with the Registrar of Limited Partnerships. A registration fee of £500 is payable for initial registration. Registration (by filing a declaration in accordance with the law) can be achieved on a same day basis for payment of an enhanced fee and otherwise takes two to three days.

The registration declaration sets out the name and registered office of the partnership, the name and address of the general partner and details of the duration of the partnership.

A fund vehicle will also need approval from the Jersey Financial Services Commission and there are currently several tiers of regulation. For a fund that will be offered to more than 50 potential investors, there are three different tiers of regulation under the Collective

Investment Funds (Jersey) Law 1988 (the CIF Law), which typically apply to LBO funds. An unregulated fund for eligible investors is the lightest touch and is unregulated. Notification of its establishment is made to the JFSC. An expert fund is a lightly regulated vehicle aimed at expert investors and, provided the fund and its service providers meet the criteria, regulatory approval can be obtained within three business days. An unclassified fund is aimed at investors who are not expert and both the fund promoter and the fund establishment documentation will be reviewed by the JFSC. Time for approval of an unclassified fund is generally four to six weeks. For expert funds and unclassified funds a fee of £1000 is payable for the certificates required under the CIF Law. The general partner of an unregulated fund, an expert fund or an unclassified fund will pay a fee of £2000 for registration under the Financial Services (Jersey) Law 1998 (the FS Law). Similar annual fees are payable.

For a private fund offered to fewer than 50 investors, approval under the Control of Borrowing (Jersey) Order 1958 is required. Such approval will generally take four to six weeks. No fees are payable.

Jersey fund administrators and legal advisers handle the formation process. No minimum capitalisation requirements apply to the fund vehicle.

3 Requirements

Is an LBO fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

A limited partnership must have a registered office in Jersey and maintain specified records at that office, including the register of limited partners and the amounts contributed by the limited partners. An expert fund will need to appoint a 'monitoring functionary' in Jersey whose role is to review compliance with the investment parameters and restrictions. Generally this role is fulfilled by a local administrator. An unclassified fund and a private fund will be expected to appoint a local administrator.

Typically as an LBO fund is a closed ended structure, the regulator does not require the appointment of a local custodian, although custody arrangements must be satisfactory to the regulator.

4 Access to information

What access to information about an LBO fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The records that a limited partnership is required by law to maintain at its registered office are available for inspection and copying without charge at the request of a partner but are not available to

the public.

The registration declaration and certificate of registration (and any amendments to either of them) are available to the public from the Registrar of Limited Partnerships.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in an LBO fund formed in your jurisdiction not be respected as a matter of local law?

A limited partner is not liable to creditors of the partnership unless the limited partner participates in the management of the partnership. A limited partner who does participate in the management of the partnership shall be liable, on the insolvency of the partnership, only to persons who transacted with the partnership with actual knowledge of the participation of the limited partner in the management of the partnership and who reasonably believe the limited partner to be a general partner. There are extensive safe harbours whereby a limited partner will not be considered to be participating in management. These include where the limited partner acts as an agent of or contractor for the limited partnership, an adviser to the general partner, or approves or disapproves activities of the partnership such as acquisitions, sales, creation of liabilities of the partnership or transactions where a conflict of interest arises.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to an LBO fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

A limited partnership must have at least one general partner and at least one limited partner. Each general partner will owe fiduciary duties to the other partners including a duty to act in good faith, a duty to account for profits received, and a duty not to compete with the partnership without consent of the partners. Certainly the duty not to compete is generally addressed in the partnership agreement, permitting the general partner to conduct the business of existing, prior vintage funds and, once the current fund is largely invested, to raise new funds.

Generally, the partnership agreement will provide for the appointment of a manager or investment manager by the general partner. The duties of the manager or investment manager will be defined by the terms of their appointment rather than the partnership agreement, as the investment manager or adviser will not commonly be a partner.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of an LBO fund?

The court of appeal in Jersey has described gross negligence as meaning a serious or flagrant degree of negligence, a marked departure from the standard to be expected in the circumstances, beyond mere ordinary negligence. It involves no question of intentional or reckless fault. It is likely that any exculpation clause will be construed restrictively and any doubt resolved against the manager relying upon it where the manager is a paid professional holding itself out as having particular expertise in the area of services provided.

In the context of unclassified funds and some private funds, the regulator will not generally permit an indemnity or exculpation of

liability to extend to negligence, wilful default, bad faith or fraud, so the 'gross negligence' debate is not relevant.

8 Other special issues or requirements

Are there any other special issues or requirements particular to LBO fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

There are no such special issues or restrictions; these matters are typically governed by the partnership agreement constituting the fund and the subject of negotiation with investors at the time of fund formation. The conversion or redomiciling of limited partnerships to Jersey is not currently contemplated by statute.

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of LBO funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the LBO fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the LBO fund's sponsor (eg, automatic trigger of dissolution or removal rights at fund level)?

The consequences depend on the regulatory status of the fund. For an unregulated fund there are no regulatory consequences. For an expert fund, a sponsor's bankruptcy or change of control is likely to have an impact on the regulatory requirement that the fund's investment manager be regulated in an approved jurisdiction and may need approval of the JFSC or notification. For an unclassified fund or a private fund, such a bankruptcy or change of control is likely to be considered a material change requiring regulatory approval.

In each case the legal consequences will depend on the terms of the fund's constitutional documents and contractual arrangements.

Regulation, licensing and registration

10 Principal regulatory bodies

What are the principal regulatory bodies that would have authority over an LBO fund and its manager in your jurisdiction, and what are the audit and inspection rights available to those regulators?

The Jersey Financial Services Commission (JFSC) is the principal regulator of funds established in Jersey and of fund services providers carrying on business in Jersey. Expert funds, unclassified funds and private funds are required to submit annual audited accounts to the regulator and allow the regulator access to books and records. Unregulated funds are not required to provide audited accounts or inspection rights. Regulated fund managers (and other service providers) in Jersey must submit audited accounts within four months of their financial year end and allow the regulator access to their books and records. Typically the GP of a Jersey fund will be established in Jersey and will therefore be regulated and subject to these requirements.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to an LBO fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

See question 2 regarding the different categories of licensing and registration, namely unclassified, expert, unregulated and private funds.

As well as certificates to be granted to a regulated fund under the CIF Law, the general partner (if in Jersey) will need to obtain registration under the FS Law.

12 Registration of investment adviser

Is an LBO fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

Only persons incorporated in or carrying on business in or from within Jersey are required to register under the FS Law. Typically the investment manager is not in Jersey and so no Jersey registration is required. However, generally the general partner of a fund will be incorporated in Jersey and that company will be required to register under the FS Law. See question 13 regarding implications of registration. Each of the directors, 10 per cent owners and other key persons of the general partner must be approved by the JFSC.

13 LBO fund manager – requirements

Are there any specific qualifications or other requirements imposed on an LBO fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

For an expert fund the fund manager must meet certain 'fit and proper' criteria, which are certified to the JFSC by the local functionary. These include that the manager is regulated in the conduct of its business in a jurisdiction approved by the JFSC. For an unclassified fund, the JFSC will consider the reputation, regulatory status and track record of the 'promoter' and requires that a manager in Jersey is appointed. Any Jersey resident functionary (including general partners and managers incorporated in Jersey) must be registered under the FS Law and will be subject to the requirements specified by codes of practice promulgated by the JFSC. The specific requirements include training and relevant experience of senior management and staff; financial resources, insurance cover, risk management and integrity. The application of these requirements varies depending on the nature of funds managed. The general partner of a fund that is an expert fund is not required to comply in full with the detailed terms of the codes of practice but instead must have regard to the general principles espoused by the codes of practice when carrying on its business.

Taxation

14 Tax obligations

Would an LBO fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors?

Please describe what conditions, if any, apply to an LBO fund to qualify for applicable tax exemptions.

A limited partnership will be tax transparent in Jersey and non-resident partners will not be subject to any tax in Jersey on their income and gains arising from their partnership interests save in respect of Jersey source income (but excluding bank interest earned in Jersey). Typically LBO funds are structured so that they earn no Jersey source income or capital gains (other than bank interest). The European Savings Tax Directive has been implemented in Jersey by local legislation (Jersey is not part of the European Union for tax purposes) and so it is possible that interest income from loans made to a partnership by individuals resident in the EU will be subject to retention tax in compliance with the EUSD. Generally funds can be structured so as to ensure that this is not applicable, either by ensuring investors are not EU resident individuals or that investment is by way of capital contribution rather than loan.

15 Local taxation of non-resident investors

Would non-resident investors in an LBO fund be subject to taxation or return-filing requirements in your jurisdiction?

No. However, see question 14 with regard to the European Union Savings Tax directive and retention tax applicable to interest income payable by the fund to individual (but not corporate) European residents. Where the LBO fund does generate Jersey source income, the general partner is responsible for making a return of income liable to Jersey income tax.

16 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of an LBO fund vehicle formed in your jurisdiction? Are there any special rules relating to investors that are residents of your jurisdiction?

It is usual to obtain a tax clearance on the question of whether the trading profits of the limited partnership are derived from international activities and therefore not Jersey source income. The general partner is responsible for making a return of income tax in respect of Jersey resident investors.

17 Organisational taxes

Must any significant organisational taxes be paid with respect to LBO funds organised in your jurisdiction?

No organisational taxes are payable.

18 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to an LBO fund's sponsor.

None where the sponsor is not a Jersey resident.

19 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Jersey does not have an extensive tax treaty network.

20 Other significant tax issues

Are there any other significant tax issues relating to LBO funds organised in your jurisdiction?

No.

Selling restrictions and investors generally

21 Legal and regulatory restrictions

Describe the principal legal and regulatory restrictions on offers and sales of interests in LBO funds formed in your jurisdiction, including the type of investors to whom such funds (or LBO funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

The raising of money in the island (by circulation of an offer or otherwise) is governed by the Control of Borrowing (Jersey) Order 1958 (as amended) (COBO). Typically an LBO fund will be structured as a limited partnership. Under COBO the consent of the JFSC is required to circulate any offer for subscription, sale or exchange of any partnership interest not being a Jersey limited partnership. On strict interpretation, there are no private placement exemptions from this requirement.

Update and trends

The introduction of the expert fund regime in 2004, allowing wider marketing to expert investors of Jersey LBO funds than previously, with a light regulatory touch was a significant development which has substantially enhanced Jersey's offering. The introduction of the unregulated fund regime in 2008 and in September 2008 its extension to limited partnerships is another major development demonstrating a recognition by the Jersey Financial Services Commission that institutional and sophisticated investors into private equity should be given the freedom to look after their own interests and manage their own risks without the burden of unsuitable regulation.

Both the introduction of the expert fund and the introduction of the unregulated fund have led to significant developments within the fund services industry in Jersey, with established operators enhancing their offering and new entrants increasing the competitiveness of the jurisdiction.

Proposed refinements to the limited partnerships law in Jersey and the introduction of incorporated limited partnerships and unincorporated limited partnerships with separate personality are likely to increase the appeal of Jersey as a preferred domicile and administration centre for private equity funds. The jurisdiction had at 31 December 2008 over £240 billion invested in funds serviced in Jersey.

It is likely that the forthcoming year in Jersey will reflect a number of common trends: an increase in secondary activity with transfers of LP interests rising as overcommitted investors seek to rationalise their portfolios; a rise in opportunistic or distressed (and mezzanine) funds being raised to take advantage of pricing opportunities coming out of the financial crisis and widespread recession, and the shortage of available credit,; and possibly consolidation among fund sponsors.

A slightly different regime applies to the circulation of an offer for subscription, sale or exchange of any securities of a non-Jersey company: so long as the company has no relevant connection with Jersey and the offer is made to fewer than 50 persons in the Island or is valid in the UK or Guernsey and is made in a similar manner to that in the UK or Guernsey, no JFSC consent is needed.

22 Types of investor

Describe any restrictions on the types of investors that may participate in LBO funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Participation in unregulated funds is restricted to eligible investors – certain types of high net worth and institutional investors or investors committing a minimum of US\$1 million (or currency equivalent). Participation in expert funds is restricted to expert investors – high net worth and institutional investors or investors committing a minimum of US\$100,000 (or currency equivalent).

23 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in an LBO fund (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

No filings or notifications are required with respect to identity of investors. Change in ownership management or control of the fund or manager is likely to require regulatory approval, in relation to the manager or GP as a result of registration under the FS Law.

24 Licences and registrations

Does your jurisdiction require that the person offering interests in an LBO fund have any licences or registrations?

Any distributor carrying on business in Jersey or incorporated in Jersey and carrying on business anywhere must be registered with the JFSC under the FS Law. Similarly, the GP if incorporated in Jersey or carrying on business in Jersey is likely to be required to register under the FS Law.

25 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in an LBO fund or the individual members of the sponsor.

The GP and any other Jersey based functionary will be required to comply with the requirements of the Money Laundering (Jersey) Order 2008. This requires both due diligence and record keeping in relation to the identity of investors.

Exchange listing

26 Listing

Are LBO funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

The Channel Islands Stock Exchange accepts for listing a wide variety of funds and fund structures including limited partnership interests. However it is unusual for limited partnership interests to be listed, principally due to the unfunded commitment obligation on the partnership interests.

The principal initial requirements for listing are: the fund board and investment manager must have satisfactory experience in the management of investments of the type in which the fund proposes to invest; the fund board must be able to demonstrate its ability to act independently of the investment manager; the fund must have acceptable arrangements for safe custody of assets; interests must be freely transferable (save where permitted by the Exchange, or where there is an unpaid call) and any restrictions on transfer must not prevent dealings from taking place on an open and proper basis; the entire class of securities must be listed and at least 25 per cent of the listed class must be in public hands.

Ongoing requirements include the publication of annual audited financial statements and half-yearly reports; investor approval of substantial transactions (those with financial thresholds exceeding 50 per cent on a number of metrics); publication of details of disclosable transactions (financial thresholds above 15 per cent on a number of metrics); approval of transactions with connected persons; and a general duty to announce through the exchange any information which is necessary to enable the holders of securities and the public to appraise the position of the fund, or which is necessary to avoid the

establishment of a false market in the securities, or might reasonably be expected materially to affect market activity in and the price of the listed securities.

The Channel Islands Stock Exchange is recognised or approved by a wide variety of tax and regulatory authorities in other jurisdictions (including HM Revenue & Customs, the UK FSA and the SEC of the USA). As a listed security on a recognised stock exchange the partnership interests will be eligible for investment by a wider variety of investors and will conform to the investment requirements of a broader class of institutional investors. The disadvantage is the additional administrative burden of compliance with the listing rules and the public manner in which the fund will be obliged to conduct its activities due to the disclosure obligations imposed on a listed issuer.

27 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

The CISX permits, as a special condition, limits on the categories of investors that may be permitted to invest and minimum transaction sizes. In addition, securities may be subject to transfer restrictions or compulsory redemption where a holding of securities may result in a regulatory, pecuniary, legal, taxation or material administration disadvantage to the fund or its investors as a whole or to maintain a minimum holding per holder.

Participation in LBO transactions

28 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in LBO transactions or otherwise affect the structuring of LBO transactions completed inside or outside your jurisdiction?

Any restrictions should be disclosed in the offer documentation. Otherwise generally no restrictions are imposed.

29 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

Provided the compensation structure is properly disclosed in the offering documents, Jersey would not generally seek to prescribe any particular compensation or profit-sharing arrangement.

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