KIRKLAND & ELLIS LLP

KIRKLANDPEN
Private Equity Newsletter

May 18, 2010

EU Alternative Investment Fund Managers Directive: Are We Nearly There Yet... ?

PENpoints

Although two key votes on the EU Alternative Investment Fund Managers Directive took place this week, it is not a done deal, with certain major issues still up for negotiation.

After repeated delays and deferrals, two key votes on the EU proposals for regulating alternative investment fund managers, including private equity and hedge fund managers—known as the Alternative Investment Fund Managers Directive ("AIFMD")—took place this week. Although these votes move the process forward significantly, the AIFMD is still not a done deal. There is one more round of negotiations to go, and certain major issues—including the rules that will apply to non-EU fund managers—remain subject to negotiation.

What Do This Week's Votes Mean?

The EU legislative process is relatively complex. Legislation is proposed by the EU Commission, and then must be agreed by both the Council (composed of ministers representing each EU government) and the directly-elected European Parliament before becoming law.

The Commission first proposed the AIFMD at the end of April 2009.[1] Over the past year, the Council and Parliament (through its Committee on Economic and Monetary Affairs, the "ECON" committee) have been reviewing and amending the legislation internally. As a result of this week's votes, each has put forward its opening position for the final round of negotiations (known as "trilogues"), which are expected to produce final form legislation later this summer.

In many areas, such as the application process for becoming an authorised fund manager and the rules on conduct of business, the Council and Parliament are broadly in agreement, so these provisions are not likely to change materially. However, a number of substantial differences remain, with the possibility of significant changes before agreement is finally reached.

Key Negotiation Points

There are two key issues subject to negotiation, although Parliament has informally indicated it intends to hold firm to its position on each of them:

- *The rules for non-EU fund managers.*

  Parliament believes that non-EU fund managers should be allowed to provide fund management services within the EU, and to market non-EU funds to EU-based investors, on exactly the same basis as EU fund managers. But to obtain these benefits, non-EU fund managers would be required to comply fully with the AIFMD on a voluntary basis under the supervision of their own domestic regulator (applying the EU rules) and, indirectly, under the overall supervision of the new EU financial services regulator.

  The Council, on the other hand, would allow individual EU countries to keep their existing private placement regimes for non-EU fund managers, provided that those fund managers comply with the AIFMD disclosure and transparency requirements, including portfolio company disclosure requirements in relation to EU investments.

- *"Asset stripping" by private equity firms.*

  The issue of perceived asset stripping was not expressly addressed in the original AIFMD draft, but Parliament is keen that rules be adopted to ensure that businesses survive long term for the benefit of their employees. The ECON amendments therefore include rules requiring fund managers to set limits on the amount of leverage to be employed in respect of each fund. The fund's

INSIDE KIRKLANDPEN

regulator would determine whether these limits are reasonable and enforce compliance with them. Parliament would also introduce rules limiting the extent to which portfolio company assets may be used to finance an acquisition.

Other likely areas of negotiation include:

- *Scope and exemptions.*

  The Council would exclude smaller fund managers from the AIFMD by reference to AUM (assets under management) thresholds. Broadly speaking, hedge fund managers would be excluded if their aggregate AUM is less than €100 million, and private equity fund managers would be excluded if their aggregate AUM is less than €500 million.

  Parliament takes a different approach, bringing all firms within the scope of the AIFMD, but exempting certain types of fund managers from some of its provisions. While this approach has clear benefits—for example, private equity fund managers would be exempted from the requirements relating to regulatory capital, depositaries and independent valuation—it may be less palatable for smaller firms than the Council's proposal.

- *Portfolio company disclosure.*

  The portfolio company disclosure requirements in the ECON draft are significantly more onerous than those in the Council draft, giving rise to fears that portfolio companies may be required to disclose commercially sensitive information. There are three elements of concern in relation to the ECON proposals:

  1. the information to be disclosed is extensive (including, for example, operating and financial information, details about the management compensation package and the profit made on any sale of the company);
  2. the information would be disclosed not only to fund investors and regulators, but also to employee representatives; and
  3. the disclosure requirements would be triggered once a fund acquires a 10 percent stake (whereas the Council proposals would only require firms to comply in relation to majority-owned portfolio companies).

What Next?

Now that ECON and the Council have published their initial positions, the negotiations may begin. The Commission is aiming to have a final version of the legislation agreed by the end of July.

Technical Briefing Note Available

A technical briefing note is also available, which explains the provisions of the Council and the ECON texts in detail. If you would like to receive a copy of this note, please contact one of the following Kirkland authors or your regular Kirkland contact.

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[1] See our *Kirkland Brief*.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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PENbriefs

Delaware Supreme Court Issues Ruling Affecting Contests for Corporate Control

In a recent decision, *Crown Emak Partners, LLC v. Kurz*, the Delaware Supreme Court made certain rulings in connnection with proxy contests, including that (1) a bylaw amendment reducing the size of a board is invalid if it prematurely terminates the term of a sitting director; (2) the "Cede breakdown," which sets forth the banks, brokers and others who hold shares through DTC and its nominee Cede & Co., is part of the "stock ledger" of a company for purposes of determining who may vote on matters that come before stockholders; and (3) in order to prevent illegal "vote buying" (which the Court found did not occur in *Kurz*), Delaware courts will "closely scrutinize" situations where the voting rights and economic interests in shares have been separated. To learn more, please see our recent *M&A Update*.

Banker Beware

A recent Delaware Chancery Court decision denying a preliminary injunction to block a merger suggests increased sensitivity around issues of conflicts of interest for financial advisors. While the proxy materials in that case disclosed that the financial advisor for one party had earlier represented the other on an unrelated matter, they did not disclose that the "day-to-day" banker, or "No. 2 fellow," worked on both engagements. Calling it a "close issue," the court refused to block the merger, but signaled that the identity of individual bankers and the interval since the advisor's last engagement for the opposing party could give rise to a conflict of interest that must be disclosed. To learn more, please see our recent *M&A Update*.

PENnotes

Thunderbird Global Secondary Investing Conference
New York, New York
May 20, 2010

This seminar, hosted by the Thunderbird Global Private Equity Center, will focus on industry trends in the secondary market, such as the latest pricing trends, who's buying LP interests, information on preparing for going to market, types of deal structures and legal considerations. Kirkland partner Michael D. Belsley will moderate a panel titled "Getting to Yes: Closing the Bid/Ask Spread" at this event.

The Road from Ruin: How to Revive Capitalism and Put America Back on Top
New York, New York
May 20, 2010

This discussion and book signing, hosted by Kirkland & Ellis and the Columbia Business School Alumni Club, features Matthew Bishop, U.S. Business Editor and New York Bureau Chief of The Economist magazine, who is co-author of *The Road from Ruin: How to Revive Capitalism and Put America Back on Top*. Written with Michael Green, the book delves into what can be learned from financial crises of the past to help set the agenda for a reformed 21st-century capitalism. To register for this event, please visit www.kirkland.com/roadfromruin.

ACG Chicago's "Is Venture Capital a Valid Asset Class?"
Chicago, Illinois
May 24, 2010

This program, hosted by the Association for Corporate Growth, will focus on the validity of venture capital in the Midwest, nationally and globally. Kirkland partner Bruce I. Ettelson, P.C., will moderate a panel of venture GPs titled "The Risks & Rewards of Driving Investing in New Corporate Growth: How Venture Capital Firms are Navigating the Waters Going Forward." The panelists will discuss the current fundraising environment for venture funds and its implications for venture capital financing transactions.

Infoline's "Private Equity Regulation & Compliance Conference"
London, UK
May 25, 2010

This conference, hosted by Infoline, will provide a practical update on regulatory and compliance developments for private equity firms. Kirkland partners Lisa Cawley and Stephanie Biggs will speak on "An Overview of U.S. Changes in Regulation Impacting Private Equity Firms."

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's nearly 400 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. Kirkland received the 2009 and 2008 awards for Best Law Firm (Private Equity Deals) in North America from *Private Equity International*. In *Buyouts Yearbook 2010*, Kirkland was named "Best Law Firm." Additionally, Mergermarket ranked Kirkland first by volume for North American Buyouts and Exits in its "North American Private Equity in Review for 2009," and Pitchbook named Kirkland as one of the most active law firms representing private equity firms in its "Private Equity Breakdown" in 2009.

The Lawyer magazine recognized Kirkland as one of the "The Transatlantic Elite" in 2008, 2009 and 2010, noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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