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The International Comparative Legal Guide to:

Private Equity 2019

5th Edition

A practical cross-border insight into private equity

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PREFACE

We are privileged to have been invited to preface the 2019 edition of *The International Comparative Legal Guide to: Private Equity*, one of the most comprehensive comparative guides to the practice of private equity available today. The Guide is in its fifth edition, which is itself a testament to its value to practitioners and clients alike. Dechert LLP is delighted to serve as the Guide's Editor.

With developments in private equity law, it is critical to maintain an accurate and up-to-date guide regarding relevant practices and legislation in a variety of jurisdictions. The 2019 edition of this Guide accomplishes that objective by providing global businesses leaders, in-house counsel, and international legal practitioners with ready access to important information regarding the legislative frameworks for private equity in 31 different jurisdictions. This edition also includes five general chapters, which discuss pertinent issues affecting private equity transactions and legislation.

The fifth edition of the Guide serves as a valuable, authoritative source of reference material for lawyers in industry and private practice seeking information regarding the procedural laws and practice of private equity, provided by experienced practitioners from around the world.

Christopher Field & Dr. Markus P. Bolsinger

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Australia

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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?

Buyouts constitute the most common type of private equity (**PE**) transaction in Australia, with Australian buyout funds accounting for more than six times the assets under management (**AUM**) of growth, balanced, co-investment, direct secondaries and turnaround funds combined. Buyouts generated 79% of total new fund commitments raised for PE and venture capital in 2018.

The current high levels of dry powder amongst PE funds have not been seen since December 2011. The Australian Investment Council (**AIC**) recently reported that investment activity rebounded in 2018, with the number of buyout deals slightly up (to 75 for the year) and aggregate value up a sizeable 89% (to $12.5 billion) compared with 2017, which had the second lowest number of transactions in the previous 10 years.

There has also been a slight recovery in the aggregate value of exits completed, from $8.1 billion in 2017 to $9.2 billion in 2018. Fewer PE-backed IPOs were also recorded than in previous years, with only nine recorded in 2018 and four in 2017 (with all nine 2018 IPOs finishing the year lower than their listing prices). PE managers often run a "dual-track" exit process, but are more commonly opting for trade sale exits, culminating in a record 73% of buyout exits conducted by way of trade sale in 2018.

The last two or three years have also seen more co-investment opportunities being sought by superannuation (pension) and sovereign wealth funds. These opportunities prove attractive to such funds which have the bandwidth and experience to be involved in the management of such investments, while offering exposure to the PE sector and limiting the management and performance fees that would otherwise be imposed. From the perspective of PE funds, this reduces the need for "club deals" with other PE funds for larger acquisitions and gives small- and mid-cap PE funds exposure to larger deals than would normally be available to them. Recent high-profile examples of such co-investments include AustralianSuper teaming up with BGH Capital on its bids for ASX-listed companies, Healthscope and Navitas.

Similar large take-private transactions have featured prominently in recent times, with other notable examples being EQT Infrastructure's recently aborted bid for Vocus Group, KKR's acquisition of MYOB and TPG's takeover of Greencross. According to the AIC, the volume of PE-backed bids for ASX-listed companies is the highest since 2006.

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

Factors encouraging investment include low interest rates and the low Australian dollar. This is coupled with recent data published by Cambridge Associates showing the Australian PE industry performing as well as their North American and European counterparts (and slightly ahead of developed Asia) over a 20-year sample, having delivered an annualised return of 13% over that period.

Factors inhibiting investment include intense competition for value investments, with high-profile figures from the Future Fund and Bain & Company recently commenting that the Australian PE industry may be peaking.

1.3 What trends do you anticipate seeing in (i) the next 12 months and (ii) the longer term for private equity transactions in your jurisdiction?

PE is expected to be a significant contributor to Australian M&A transactions in 2019. This is notwithstanding the fact that the local market is under-represented in terms of PE activity, which typically accounts for about 15% of M&A activity (compared to 30% in more established markets).

Given the high levels of dry powder amongst PE funds and intense competition for value investments in private companies, we anticipate public-to-private bids becoming more prevalent. PE managers are expected to seek out bilateral transactions for assets, rather than competing with their contemporaries in auction processes in order to provide alternative forms of investment in attractive businesses through private credit or special situation funds.

Until IPO markets open up again, we anticipate that the low proportion of IPO exits (comprising just 6% of all PE exits in 2018) will continue.

Warranty & indemnity (**W&I**) insurance policies are commonplace in Australia but are tending toward more extensive exclusions (see question 6.4 below), thereby limiting coverage and driving counterparties to look for other forms of contractual protection for those excluded matters.

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2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

The acquisition structure for a leverage deal most commonly involves a three-level "stack" of Australian-incorporated private holding companies, with PE investors and management taking equity in the top entity in the structure (the "HoldCo" or "TopCo"), bank debt coming in at the second level ("FinCo") and the acquisition being made by the FinCo's subsidiary ("BidCo").

2.2 What are the main drivers for these acquisition structures?

One of the drivers for the selected acquisition structure is tax efficiency. This is both from the perspective of the PE fund and the group companies: the deductibility of interest on debt repayments should be available to the group companies subject to integrity regimes, and meeting equity incentive criteria should be achieved for the management team.

The three-tiered "stack" structure also provides structural subordination for the financiers of the group, with funding coming in at FinCo level, being the middle entity of the stack positioned below the equity interests of the PE fund and management team at HoldCo level.

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

Both institutional investors and management most commonly subscribe for ordinary equity, with institutional shareholders holding ordinary shares (and potentially shareholder loans) and management subscribing for a separate class of ordinary equity, which generally has: (i) restrictions on voting rights; (ii) compulsory acquisition requirements and transfer restrictions; and (iii) may involve a ratchet on exit.

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

If a PE investor is taking a minority position, there may not be material differences in respect of structuring, save that a minority PE investor: (i) may want to protect their downside risk by seeking preference rights on a liquidation, including subscribing for convertible preference shares; and (ii) will want to carefully structure the governance arrangements in order to impose voting, veto and control rights in respect of certain matters.

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

Management is typically allocated between 5–15% of the equity in a holding vehicle, with vesting depending on the structuring of management's equity, whether the subscription proceeds have been funded by a non-recourse loan and the expected time to exit.

Compulsory acquisition provisions are often triggered by matters such as material breach of the shareholders' agreement (including transfer or assignment of shares in breach of the agreement), becoming a "bad leaver" or insolvency. The Australian *Corporations Act 2001* (Cth) (the **Corporations Act**) regulates a company's acquisition of its own shares from a shareholder.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

Leaver provisions are generally more bespoke in Australia than in the US where fairly constant formulations of good and bad leaver are typical.

In Australia, a good leaver is generally a manager who "leaves" their employment because of death, permanent disability or incapacity or redundancy or is otherwise deemed a good leaver at the discretion of the board. A good leaver would typically have their shares compulsorily acquired for fair market value (or the higher of cost and fair market value in certain circumstances).

A bad leaver is generally a manager who "leaves" their employment but is not otherwise a good leaver. Bad leavers would typically have their shares compulsorily acquired for the lower of cost and fair market value (sometimes with an additional discount to account for costs of the compulsory acquisition (e.g. the acquisition price may be 90% of the lower of cost or fair market value)). Unlike the UK, the concept of intermediate leaver is rarely, if ever, seen.

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?

PE portfolio companies are customarily private companies governed by the constitution of the relevant company (which ordinarily deals with fairly generic corporate issues) and the shareholders' agreement entered into between the PE investor, the managers, other share or right holders, and the target company (which deals with more bespoke governance and operational issues).

Neither the shareholders' agreement nor the constitution of private companies is required to be made public.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

Nominee directors of controlling PE investors (rather than the investor themselves) generally have the benefit of veto rights over major transactions and other material operational matters under a shareholders' agreement.

Minority investors normally have their veto rights restricted to key constitutional issues and highly material transactions, rather than mere operational matters.

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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?

Certain corporate actions (e.g. adopting a constitution, changing a company's name and varying or cancelling class rights) may only be effected under the Corporations Act by a special resolution of shareholders (being 75% of the votes cast on the resolution), meaning that a shareholder veto in respect of such matters by shareholders holding less than 25% of the voting shares would be ineffective under the Corporations Act, but may still be effective under a shareholders' agreement.

Although a shareholders' agreement and company constitution may include an acknowledgment that the nominee director is entitled to act in the best interests of their appointor (being the PE investor) and nominee directors may have the benefit of contractual veto rights under a shareholders' agreement, the directors will still be subject to their general fiduciary and statutory duties when exercising such rights. These include duties to act with care and diligence, in good faith, for a proper purpose, not to misuse their position, to prevent insolvent trading, to avoid conflicts, and to not fetter their discretion.

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?

There are no specific duties owed by a PE investor to minority shareholders or management shareholders (or *vice versa*). However, the minority shareholders may have the benefit of: (i) certain contractual protections in the constitution and/or a shareholders' agreement; and (ii) general statutory and common law minority shareholder protections such as the prohibition on oppression of the minority.

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)?

Generally, there are no limitations or restrictions on the contents or enforceability of shareholder agreements other than: (i) general prohibitions on the enforcement of terms which are, for example, contrary to public policy or which oppress the minority; and (ii) any restraint needs to protect a legitimate business interest and be reasonable (including the restraint period and the geographical restriction, which are often cascaded to assist with enforceability).

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?

Nominee directors should always be generally aware of their directors' duties (see question 3.3 above). They can be subject to personal liability in certain circumstances under Australian law (for example, for insolvent trading, environmental laws, work health and safety laws, complicity in tax-related offences, or for being an accessory to underpayment of employee entitlements).

PE investors should ensure that both directors' and officers' insurance policies are in place and that deeds of indemnity, insurance and access are entered into for the benefit of their nominee directors. There are certain statutory restrictions on indemnifying a director (e.g. for fraudulent acts, certain penalties and costs or liabilities to the company itself).

PE investors will generally have the benefit of the corporate veil to protect them from incurring liability on behalf of their investee companies (subject to certain exceptions such as fraud). PE investors should also be mindful of avoiding shadow director liability, which can accrue if the company becomes accustomed to acting in accordance with the investors' instructions or wishes rather than those of the nominee directors. This may arise if, to avoid issues of director duty liability, matters are routinely referred to shareholders to vote on.

In addition, Australian private companies need to have at least one Australian-resident director at all times.

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?

As noted above, the constitution of a company or a shareholders' agreement may permit a nominee director to act in the interests of a PE investor as their appointor. However, this will not absolve the director of their general law and statutory directors' duties (most relevantly, to avoid conflicts).

Where a director has a conflict of interest in relation to a particular matter, the issue may be resolved by referring it to a shareholder vote. However, the shareholder will need to be cognisant of not incurring shadow director liability (see question 3.6 above).

4 Transaction Terms: General

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

Foreign Investment Review Board (FIRB)

As mentioned in question 10.2 below, foreign PE investors (and even local PE investors which have "foreign government investors" (**FGIs**) as limited partners) often need to seek foreign investment approval for their acquisitions. Accordingly, it would be prudent for PE investors to obtain FIRB advice on transactions as soon as practicable. The FIRB must make a decision on an application within 30 days after it receives the application fee for that application. If FIRB cannot make a decision within this timeframe, it can make an interim order extending the period for up to 90 further days (having the effect of making the decision process public) or may alternatively request that the investor consents to a voluntary time extension (meaning that the decision process can be kept confidential).

Competition

There is no mandatory requirement to seek antitrust approval in Australia (called informal clearance). The antitrust approval (or informal clearance) process is voluntary and, if a party wishes to

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obtain informal clearance from the Australian Competition and Consumer Commission (**ACCC**), the timing of that clearance will vary depending on the nature and extent of competition issues arising from a transaction. As there are significant penalties for breaches of the merger competition law regime, parties often seek informal clearance for a transaction prior to completion where the transaction may give rise to competition (or anti-trust) concerns.

Where parties apply to the ACCC for informal clearance and the ACCC considers that the transaction is unlikely to substantially lessen competition in any market, the ACCC will generally "clear" the transaction within two to four weeks without conducting market enquiries.

If, however, the ACCC considers that the transaction may give rise to competition concerns, the ACCC will undertake market enquiries to test the nature and extent of those concerns. While the duration of market enquiries will depend on a number of factors including the complexity of the competition concerns and whether the parties provide further information to the ACCC, the ACCC seeks to make a decision within six to 12 weeks of commencing the market enquiries process.

Financing – financial assistance

Because the granting of security by target group members constitutes the giving of financial assistance to acquire shares of their holding company under the Corporations Act, the target companies (and the ultimate Australian holding company's shareholders) will generally need to approve the giving of such financial assistance. The corporate regulator, the Australian Investments and Securities Commission, needs to be notified at least 14 days before the financial assistance is given, meaning that, unless the sellers agree to be involved in the process, the PE investor and its financier will not be able to put in place security until at least 14 days post-completion of the acquisition. The financier will generally try to protect themselves from residual risk in this period with various undertakings from the target group until the security package is in place (see also question 8.2 below).

Change of control consents

Consents to changes in control from material contract counterparties and landlords are regularly required and obtaining the consent of such counterparties can be a time-consuming exercise. Unlike the US or the UK, most Australian leases contain a change of control restriction. Often, a PE investor will take a pragmatic approach and choose to complete even in the absence of such consent and seek the consent of such third parties post-completion.

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

Given that the Australian market is more fragmented than the US or UK markets, market terms are not as standard and, coupled with the lower volume of deals, discernible trends are less readily identified.

Recently, however, the prevalence of W&I insurance has changed the exit regime, with retentions and escrows being much less common.

Another trend in technology transactions is buyers insisting that warranties relating to intellectual property are treated as fundamental warranties (thereby availing themselves of the more favourable limitation regime (see question 6.5 below)).

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?

The Australian Takeovers Panel requires that a bidder has funding in place (or a reasonable basis to expect that it will have funding in place) to pay for all acceptances when a takeover bid becomes unconditional. A consequence of this is that in a hostile bid context, financing may be difficult to obtain in the absence of detailed due diligence (since a hostile bidder will not be granted a right to complete due diligence).

Further, to avoid potential actual or perceived conflicts of interest relating to "insiders", the Australian Takeovers Panel's Guidance Note on Insider Participation in Control Transactions requires that protocols (which are to be supervised by the independent directors) be put in place in respect of any "participating insiders" such as senior management or participating directors who will benefit from a takeover bid by a PE investor.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

PE investors may seek exclusivity protection in a public acquisition in various forms of lock-up devices such as "no shop", "no talk", "no due diligence" or "no matching rights" obligations. Break fees (not exceeding 1% of the equity value of the target) are often payable if the target walks away from discussions or chooses an alternative offer. Importantly, such protections are regularly subject to a "fiduciary out" for the directors of the target, which is a provision that allows the directors to be relieved of a lock-up obligation (or aspects of it) if their directors duties require them to do so.

A relatively new development is the use of W&I insurance for public acquisitions which are based on sole recourse to the policy and the target (rather than the seller) giving the warranties.

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?

On the sell-side, PE investors prefer all cash consideration, payable on completion (i.e. no deferred consideration, no escrow or other retention and no completion accounts adjustment). This provides the seller with certainty of proceeds and allows the investor to quickly distribute funds to its Limited Partners.

Conversely, on the buy-side, PE investors prefer deferring consideration so as to delay payment and the increase internal rate of return (**IRR**). Examples of this may include earn outs, escrows or standard deferred consideration (essentially vendor financing).

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

In Australia, unlike in the UK, PE investors are typically expected to provide the same package of warranties and indemnities to a buyer

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as those provided by the management team. As previously mentioned, exiting PE investors will typically require that a buy-side W&I insurance policy is put in place in respect of the warranties and the tax indemnity. PE sellers will often resist providing any warranties which are excluded, or only partially covered, under the relevant policy.

Similar to the US, warranties are generally given by the warrantors on an indemnity basis (unlike the UK).

In the absence of W&I insurance, a PE investor on the buy-side may take a different view as to the warranties provided by the management team depending on whether they are continuing in the business and taking material management positions, on the basis that investors will be hesitant to sue their investee company's management team for a breach of warranty.

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?

Other covenants, undertakings and indemnities provided to the buyer include those relating to conduct between signing and completion (including assistance with obtaining change of control consents), leakage covenants and indemnities (in locked box deals), access to premises, records and employees prior to completion, specific indemnities in respect of known risks or risks which are otherwise excluded under the W&I policy and management restraints (with PE sellers normally averse to agreeing to a restraint).

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

Buy-side W&I insurance is commonplace in PE transactions in Australia.

Typical excesses (or retentions) are approximately 1% of the enterprise value. Policy limits are tailored to each transaction and typically range from 20–70% of the enterprise value (matches the range of maximum liability that warrantors would normally accept in relation to non-fundamental warranties).

Typical exclusions include warranties relating to known risks, bribery, pension underfunding, forecasts and forward-looking statements, product or service liability, environmental warranties, cyber events, issues relating to the classification of contractors as employees, fraud and other matters already known to the buyer.

W&I insurance in Australia typically costs between 1–1.5% of the policy limit (including brokerage). GST and stamp duty also apply. Capped underwriting fees apply initially, but are waived on policy inception.

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

The limitation regime is generally bifurcated between:

(i) tax and fundamental warranties. These may not be subject to a *de minimis* or bucket (in the case of fundamental warranties), may not be disclosed against and generally have a time limit of approximately five years for uninsured deals or seven years for insured deals. An aggregate cap of the equity value will also generally apply; and

(ii) general business warranties (i.e. all warranties other than tax and fundamental warranties). These will typically have a *de minimis* of 0.1% of enterprise value, a bucket of 1% of enterprise value (which is normally a tipping bucket in non-insured deals and may be applied in insured deals for an additional fee), may be disclosed against, and have a time limit of at least one audit cycle for uninsured deals or three years for insured deals. The aggregate cap on liability will depend on the deal; however, a range of 20–70% of the enterprise value could apply.

A PE seller will generally try and limit its aggregate liability for all claims (including undertakings and warranties) to the equity value.

Limitations on liability in insured deals will generally match the limitation regime provided for in the W&I insurance policy.

In Australia, general disclosure of the data room against the warranties is standard. This means that, unlike in the UK where general disclosure of the data room is accepted but disclosure letters are still commonplace, disclosure letters are much less common than in the UK and the US. Even when used, disclosure letters require much less specific disclosure than in the US.

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)?

As mentioned in question 6.1 above, PE sellers strongly resist providing any security for liabilities as this would impede distributing proceeds to their Limited Partners immediately post sale. However, given the prevalence of W&I insurance, the risk is transferred to the insurer meaning escrow for warranties/liabilities is now often irrelevant.

In the absence of W&I insurance on the buy-side, PE buyers often seek an escrow or retention amount as security for warranty and/or liability claims. Escrows are more often sought from management team vendors because they are often counterparties of less financial means than institutional vendors.

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 in the absence of compliance by the buying entity (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Comfort as to the availability of debt finance is normally provided in the form of a debt commitment letter and terms sheet issued by the lead financier. Comfort as to the availability of equity finance is normally provided in the form of an equity commitment letter issued by the PE buyer. Sellers may have rights to contractual damages or to specific performance in the absence of compliance with such documents.

Less common is a non-refundable deposit which may be provided by the buyer and provides some comfort and some compensation in the event of the buyer's failure to complete a transaction.

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 not prevalent in Australian PE transactions.

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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?

Lock-ups and escrow obligations (see question 7.2 below) imposed on sellers in an IPO means that an IPO does not provide an immediate and complete exit. An IPO process is also more involved and could take longer to implement than a trade sale.

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

PE sellers are often subject to underwriter-imposed (i.e. the sellers agree to a voluntary lock-up to assist with marketing the IPO) lock-up obligations for a period of 12–24 months, often coinciding with the end of a forecast period (subject to certain exceptions if the share price outperforms the offer price).

Mandatory lock-up obligations may also be imposed on PE sellers if the listed entity is admitted through the "assets test". This would often be for a 12–24-month period depending on the circumstances.

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?

Dual-track exit processes are often cited to try and drive competitive tension, but are practically less common than singularly pursuing a trade sale exit.

The AIC has reported a continuing decline in the number of IPOs and private placements as a proportion of total buyout exits, with IPOs representing 53% of all exits in 2015, 30% in 2016, 20% in 2017 and 6% in 2018 and trade sales as a proportion of all exits increasing from 32% in 2015, to 58% in 2016, to 63% in 2017 and 73% in 2018.

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 predominant source of debt funding remains syndicated secured term loan facilities, rather than bonds and securitisation structures. Consistent with recent years, there has been a continued retreat by the Australian commercial banks from the Australian leveraged finance market, with the funding gap increasingly being filled by Australian credit funds, and offshore commercial and investment banks.

In keeping with the recent years, typical tenures are of three to five years for leveraged finance facilities, with senior debt for new transactions generally not exceeding 50% to 70% of enterprise value (depending upon sponsor and sector) but with capacity for uncommitted "accordion facilities" allowing for the top-up of senior debt for permitted acquisitions and growth capital expenditure.

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 few financing restrictions idiosyncratic to Australian leveraged finance transactions, with security being able to be granted by Australian companies to acquisition financiers (generally through a security trust mechanism). Two of the primary structuring considerations on leveraged finance transactions continue to be: (i) Australian interest withholding tax (**AIWT**) will generally apply (and be payable as a liability of the borrower through a gross-up mechanism) in relation to interest paid to non-Australian lenders who either (1) do not have an Australian lending office, or (2) are not able to rely on 100% relief under a relevant Double Taxation Treaty. An alternative statutory process for syndicated transactions to address liability for AIWT is to comply with the requirements of section 128F of the *Income Tax Assessment Act 1936* (Cth); and (ii) compliance with the statutory processes to address the Australian financial assistance prohibition under the Corporations Act (see question 4.1 above). There is a settled Australian statutory shareholder "whitewash" process which addresses the financial assistance prohibition, so it should not generally be considered an impediment to transaction execution.

8.3 What recent trends have there been in the debt financing market in your jurisdiction?

Unitranche and US Term B transactions (with and without subordinated mezzanine/second lien tranches) continue to be utilised by global sponsors for larger Australian buyouts. Active lenders include Barings, HPS, Partners Group, Macquarie Bank, Credit Suisse and Nomura. Lenders active as super-senior working capital tranche lenders include Investec, HSBC and National Australia Bank.

In relation to the domestic market (and as noted in question 8.1), the retreat of Australian commercial banks from leveraged finance credits has provided an opportunity for both Australian and offshore credit funds to provide typical syndicated (or bilateral) acquisition loans (often on a stretched basis). Active Australian credit funds include Challenger, IFM and Metrics Credit Partners. Superannuation funds such as AustralianSuper have also been participants in senior syndicated leveraged credits. Active offshore and investment banks include Bain Capital Credit, Nomura, MUFG, ING, SMBC, HSBC, Natixis and BNP Paribas.

In addition, unitranche lenders have squarely targeted the mid- to upper mid-market for good domestic sponsors and have become viable and attractive acquisition finance sources, particularly given their initial gearing of up to 5.5 times (not at a level that global sponsors will attain, but still substantially better than Australian bank lenders will be able to approve), 6+-year tenors, minimal (if any) amortisation, (generally) covenant-lite structure and pricing now in the mid 500bps. Customary call protection will likely apply but in context this is not generally seen as problematic.

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?

Offshore PE funds will often establish a special purpose vehicle

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(**SPV**) (or a chain of SPVs) under Australian law which it will wholly own. The type of structure established for the SPV will depend on the nature of the asset being acquired. This will typically be a private company to hold business assets or a unit trust to hold real property or infrastructure assets.

The benefits of the SPV being a company from an Australian tax perspective include the use of the Australian tax consolidation (or single taxpayer) regime. This will enable the purchase price for the acquired shares in the target to be "pushed down" to the underlying business assets to, in most cases, resetting their tax costs (possibly leading to an uplift in tax costs for depreciation, etc).

Where the SPV acquires a capital asset such as real property or infrastructure assets, a unit trust could be established and if it qualifies as "managed investment trust" (or **MIT**), concessional withholding tax rates of 15% may apply. This requires among other things, that the non-resident is resident in a jurisdiction with an informal exchange treaty with Australia and the MIT itself satisfies the relevant legislation requirements.

Some other considerations will be whether:

- the interest the offshore PE fund holds will be classified as either a debt or equity interest under Australia's debt/equity rules as this may result in a different tax treatment on returns made on investments;
- the Australian asset acquired by the PE fund is treated as being held on revenue or capital account;
- any cross-border dealings with related parties comply with Australia's transfer pricing and thin capitalisation regimes. These regimes seek to combat non-arm's-length dealings or interest deductions on excessive debt funding, in both cases ensuring that profits do not escape Australian taxation as a result; and
- any of the integrity regimes that have been legislated as part of Australia's response to the OECD Base Erosion Profit Shifting Action Items (BEPS Project) apply including the:
  - multinational anti-avoidance law;
  - anti-hybrid rules;
  - diverted profits tax; and
  - country by country reporting.

Offshore structures are common in the Australian PE landscape. They usually take the form of a limited partnership where the general partner is established in the Cayman Islands or British Virgin Islands and the investors are the Limited Partners either established in the same jurisdictions as the general partners or in other jurisdictions. They can also take the form of limited liability companies (**LLC**) incorporated in Delaware in the US. Such LLCs are usually tax-transparent entities in the jurisdiction of their domicile.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

Where the management teams of the Australian target entity are partly remunerated with shares or options to shares in the acquisition vehicle, they will be subject to tax in accordance with the Australian employee share scheme provisions. Under these provisions, the discount on the shares or option received will be taxed as income on either an upfront basis or on a deferred basis if the requirements for deferral are met.

Loan-funded share schemes are also common and involve loans being made to the management team to purchase the relevant shares for their market value. The loans are often secured on a limited recourse basis and repayable on an exit event.

9.3 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?

The key considerations for the management team who are Australian tax residents holding their investment on capital account where there is an exit event are as follows:

- whether they can apply the 50% CGT discount when calculating their taxable capital gains on disposal of their shares. This will require, among other things, that they hold their investment for a period of not less than 12 months and in an eligible vehicle; and
- whether they can access the scrip-for-scrip rollover relief if they receive shares in a new acquisition structure. This requires, among other things, that the acquirer becomes the holder of at least 80% of the voting shares in the target company.

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?

Some recent changes include:

- from 1 July 2018, Australia's thin capitalisation rules have been amended to deny foreign investors from using doubled geared structures to convert active business income to interest income, the latter attracting lower withholding tax rates;
- from 1 October 2018, new anti-hybrid rules have been legislated as Australia's response to Action Item 2 of the BEPS Project;
- from 1 July 2019, a minimum 30% withholding tax on trading income converted to passive income distributed by an MIT and as part of a stapled structure; and
- from 1 July 2019, existing tax exemptions for foreign pension funds and sovereign wealth funds will be limited to passive income and portfolio investments (typically interests of less than 10%).

Consultations continue in respect of legislation establishing new collective investment vehicles being the corporate investment vehicle or CCIV and a limited partnership, both intended to be recognisable to foreign investors.

10 Legal and Regulatory Matters

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

FIRB commonly imposes conditions on its approval in relation to compliance with taxation laws and data security.

A number of substantive changes to Australian competition laws came into effect toward the end of 2017 that may have an impact on certain PE investors.

See question 9.4 above for details of developments from a tax perspective.

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10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g. on national security grounds)?

PE investors (whether based locally or offshore) are often subject to enhanced regulatory scrutiny in Australia in the form of Australia's foreign investment regime. Non-Australian entities proposing to acquire an interest in, or control of, an Australian business that is valued above $266 million (or $1.154 billion for acquisitions by certain investors from the US and certain other countries) must seek the approval of FIRB. However, except in limited circumstances, a FIRB approval is required regardless of the value of the acquisition, where the acquiring entity is considered a "foreign government investor" (**FGI**).

Many foreign and even Australian PE investors meet this test due to the nature of their limited partner base. Examples of ownership that may result in classification of an investment target as an FGI include: sovereign wealth funds; banks; insurance companies and other financial institutions with state ownership in excess of 20%; and even more commonly, pension funds for state employees, public university endowment funds, etc. See question 4.1 above for the timetable implications for FIRB applications.

Particular transactions attracting enhanced scrutiny include those involving businesses which transfer personal data and transactions in the media sector or agribusiness sector involving the sale of Australian agricultural assets.

PE investors are not subject to enhanced scrutiny by the ACCC but where a transaction requires approval from FIRB, the ACCC will be asked to provide its view on whether the transaction raises any competition concerns. Accordingly, transactions notified to FIRB will be notified to the ACCC regardless of whether the parties have a desire to notify the ACCC.

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.)?

Sophisticated PE investors in Australia typically conduct very detailed due diligence in respect of acquisitions, with the approach to such diligence, the materiality thresholds and the form of any such reporting dependent on the circumstances of the acquisition. Financiers and W&I insurers (where W&I insurance is sought) typically require the comfort of a bespoke and detailed diligence process, typically (but not always) from external advisors.

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.)?

There is an increasing focus on anti-bribery or anti-corruption compliance in Australian PE transactions, particularly in transactions involving international investors (particularly North American counterparties) or, as you would expect, in respect of acquisitions of Australian businesses which conduct business in sanctioned jurisdictions or which have relationships with sanctioned or politically exposed persons. The difficulty with bribery or corruption is that they are inherently difficult to conduct due diligence on and, as a result, are typically excluded from W&I insurance coverage. As a consequence, an investor may need to seek other contractual protections in the form of specific indemnities.

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 circumstances in which a PE investor may be held liable for the liabilities of the underlying portfolio companies are limited to circumstances in which the corporate veil can be pierced. That is, through fraud or in limited circumstances through the operation of particular legislation such as acting as a shadow director or under section 545 of the *Fair Work Act 2009* (Cth), which empowers a court to make orders that an accessory (which can include shareholders, and not just an employer), to be liable to back-pay employee entitlements.

It is difficult to envisage any circumstances in which one portfolio company may be held liable for the liabilities of another portfolio company.

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?

There are limited additional concerns for PE investors in Australia not already referred to above. As noted above, the PE industry is healthy in Australia, highlighted by the record-breaking fundraising in recent times.

This chapter was prepared on the basis of laws and policies in effect as at 13 June 2019.

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