

Punching above your weight: Minority Investments in Private Equity

In recent years we have seen more of our private equity clients entering into a range of minority investments. This update provides a summary of some of the standard rights and protections being sought by private equity investors as part of their minority investments.

Board Level

Whilst it is likely that many funds will be pursuing an active management role, looking to create value and drive business, it is highly unlikely that a minority investment will come with control of the board. Indeed, whilst many minority investments will have as one of their foremost drivers the provision of particular skill sets by the fund investor, including M&A and IPO experience or access to international markets, this comes without the ability of the minority investor to force such advice upon the investee company. Rights at board level are likely to include:

- the ability to appoint director[s] and/or observer[s];
- certain information rights, including access to budgets, business plans, forecasts and projections; and
- the right to a place on the audit and remuneration committees.

Shareholder Level

Whilst the minority investor will typically not require control of the board, it customarily enjoys certain veto rights at shareholder level, the scope and number of which typically reflect the extent of its economic interest. One advantage in UK companies, of putting controls at shareholder, rather than board, level is that whilst a director must act in the best interests of, and has fiduciary duties to, the company, the minority investor, as shareholder, is not restricted by any similar constraints and may vote its shares as it sees fit in its own interests. This may vary according to the jurisdiction. Veto rights include matters such as:

- the amendment of governing documents (articles of association);
- significant transactions by the investee company including acquisitions, disposals, financing, material litigation and appointments;
- the issue of new securities; and
- the winding up of the company or significant changes in its business.

If you have any questions about this update, please get in touch with:



Perry Yam

Partner, Private Equity

T: +44 20 3130 3222

E: pyam@mayerbrown.com



James West

Partner, Private Equity

T: +44 20 3130 3311

E: jwest@mayerbrown.com

Step in Rights

Irrespective of its minority position, the private equity investor may want the ability to take control of the company in the event that things are going badly. As with the veto rights, the ability to insist on this protection is usually related to the percentage stake in the company and/or the respective bargaining strength of the parties. This right may be triggered by a number of pre-agreed events, including poor financial performance (based on pre-agreed thresholds), breaches of financial covenants in financing arrangements or material breaches of the shareholders' agreement and/or shareholder loan note documents.

The rights of the minority investor upon such events occurring will vary and will range from the ability to approve and enforce emergency business plans and actions, to the right for the minority investor to take control of the board ("swamping rights") and, often, the voting rights attaching to the shares in the company in order that the minority investor can push through any actions it deems necessary to rectify the relevant issue. The "step in" rights will usually fall away once the relevant set of facts leading to the trigger have been reversed.

Anti-Dilution

A minority investor will nearly always look for anti-dilution protection. This will often take the form of both a pre-emptive right to participate in a fresh issue of shares pro rata to the relevant shareholders current holding, as well as a right to a bonus issue of shares in the event that a fresh issue takes place at a price per share below the initial price per share subscribed by the minority investor.

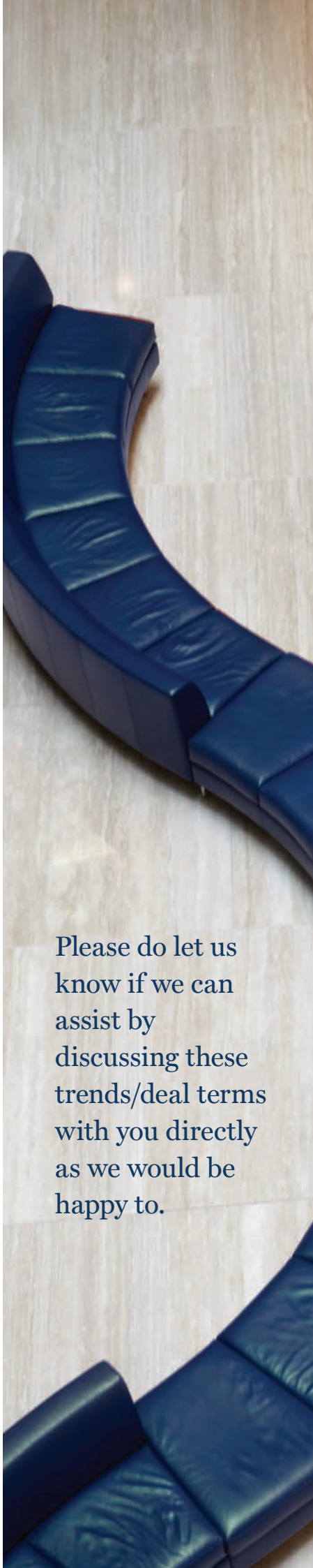
Exit

In a typical majority investment, the private equity investor makes the sole determination as to the timing and form of an exit. In a minority investment the minority investor will not automatically control the exit process, and indeed is often the only seller, with the majority wishing to remain. A minority investor must therefore seek to set out in the shareholders' agreement a clearly defined process for exit which will include:

- a general obligation on the board/shareholders to pursue an exit within a given timeframe. This often includes the right for the minority investor to appoint advisers/bankers for the company and to participate in discussions relating to an exit (sale or IPO);
- drag along rights giving the parties the ability to seek a sale of their shares to a third party after a given period of time and to compel the other shareholders to sell with them upon the same terms;
- tag along rights giving the shareholders a right to tag their shares to any permitted third party sale upon the same terms; and
- "put rights" that allow the minority investor to put its shares onto the other shareholders at a certain time and at a certain price per share.

EU Merger Controls

When the sponsor invests in a particular industry segment, an industry where perhaps it may already be an investor, the activities of the investee company may need to be aggregated with those of the investor's prior investments for the purposes of EU merger controls. To be clear, this will only be relevant if the minority investor obtains "control" of the investee company through its minority investment. Under EU merger control rules, control is defined as the ability to exercise "decisive influence" over an entity, which typically would require an ability to influence (e.g. via a veto right) one of the following: the budget, the business plan, senior hires and fires and investments (where the thresholds for these are set at a level where the veto is likely to allow control over day to day operations). These veto matters are, of course, standard fare for minority investors. As such, care should be taken in considering whether the minority investor has businesses which compete with the investee company in its existing portfolio and, if so, whether the EU merger control rules might apply to such minority investment.



Please do let us know if we can assist by discussing these trends/deal terms with you directly as we would be happy to.

Our Private Equity practice

Mayer Brown is a leading international legal adviser to a vast array of private equity funds, portfolio companies and management teams. The Mayer Brown's Private Equity practice is unique with representation across four continents. Our private equity team aims to deliver creative and practical solutions to the often complex issues faced by our clients in today's business environment.

Our private equity clients span a range of fund structures and geographic or industry focus, including traditional private equity funds, captive funds, pledge funds, venture capital funds, infrastructure funds, real estate funds, funds of funds, secondary funds and debt and mezzanine funds. We also regularly represent portfolio companies and management teams in a wide range of private equity transactions. We pride ourselves on forging long-term relationships with our clients that begin with fund formation and continue throughout their investment activities and exit strategies.

Our cross-practice teams are led by a global team of seasoned lawyers with extensive transactional experience.



1,500

Lawyers world-wide.



250

Chambers-ranked
Lawyers.



24

Offices located in
the Americas, Asia,
Europe and the
Middle East.



Clients' global,
cross-border legal
needs all fully
supported. A wide
selection of practices
servicing key
industries

Mayer Brown at a Glance



Law360 2016 included Mayer Brown, for the sixth consecutive year, in their Global 20 list of law firms with the greatest worldwide reach and expertise.



BTI Consulting Group has ranked Mayer Brown in the top half of the 2016 Client Service 30 – BTI's annual list of the 30 law firms who "outpace all other firms in service" and "impress clients with their savvy."

Americas | Asia | Europe | Middle East | www.mayerbrown.com

MAYER • BROWN

Mayer Brown is a global legal services provider advising many of the world's largest companies, including a significant portion of Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Mayer Brown comprises legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe-Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown Mexico, S.C., a sociedad civil formed under the laws of the State of Durango, Mexico; Mayer Brown JSM, a Hong Kong partnership and its associated legal practices in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. Mayer Brown Consulting (Singapore) Pte. Ltd and its subsidiary, which are affiliated with Mayer Brown, provide customs and trade advisory and consultancy services, not legal services.

"Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

© 2017 The Mayer Brown Practices. All rights reserved.

Attorney advertising. Prior results do not guarantee a similar outcome.