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Weil News

- The 2009 Edition of Best Lawyers in America named our following partners in the areas of Leveraged Buyouts, Private Equity Law or Private Funds Law: Christopher Aidun, David Duffell, Shukie Grossman, David Kreisler, Steven Peck, Charles Robins, Jay Tabor, Jeffrey Tabak, Doug Warner, Glenn West, James Westra and Barry Wolf
- Weil Gotshal advised Lehman Brothers Holdings Inc. in connection with the sale of certain equity, investment advisory and management interests in certain private equity funds managed by Lehman Brothers Merchant Bank to Reinet Investments
- Weil Gotshal advised Goldman Sachs Credit Partners, JPMorgan Securities, Bank of America Securities, Barclays Capital and Citigroup in connection with the $26.5 billion credit facilities to fund Pfizer's acquisition of Wyeth
- Weil Gotshal advised Providence Equity Partners and Newbridge International Investment in connection with their $290 million take private of eTelecare Global Solutions
- Weil Gotshal advised Providence Equity Partners and World Triathlon Corporation in connection with the acquisition of North America Sports, Inc. and NA Sports Inc.
- Weil Gotshal advised Eyeglass World (a portfolio company of Summit Partners) in connection with its acquisition by National Vision Inc.
- Weil Gotshal advised American International Group in connection with the sale of its commodity index trading business to UBS

The Hedge Fund Transparency Act: More Than It Seems

By Jeffrey Tabak (jeffrey.tabak@weil.com), Richard Ellenbogen (richard.ellenbogen@weil.com) and Brett Bush (brett.bush@weil.com)

On January 29, 2009, Senators Charles Grassley (R-IA) and Carl Levin (D-MI) introduced a bill in the U.S. Senate titled the "Hedge Fund Transparency Act" (the "HFTA"). The HFTA would require that private investment entities (not limited to hedge funds, as the title states) with assets of $50 million or more register with the Securities and Exchange Commission (the "SEC") and provide specified information about the private investment entity and its investors. The HFTA could also require that the investment adviser to any such private investment entity be registered under the Investment Advisers Act of 1940 (the "Advisers Act").

Exemption, Not Exception

The HFTA proposes to amend the Investment Company Act of 1940 (the "1940 Act") by removing Sections 3(c)(1) and 3(c)(7), which are the bases upon which most private investment entities (including hedge funds, venture capital funds, private equity funds and many securitization structures, and many privately-held capital intensive and development stage companies) are excluded from the definition of, and the extensive regulation associated with being, an "investment company" under the 1940 Act.

The HFTA proposes new Sections 6(a)(6) and 6(a)(7) of the 1940 Act which substantially restate current Sections 3(c)(1) and 3(c)(7), respectively. However, proposed Section 6(g)(1) provides that a private investment entity relying on Section 6(a)(6) or 6(a)(7) with assets of $50 million or more would be deemed to be an investment company, but would be exempt from compliance with the substantive requirements of the 1940 Act only if it registers with the SEC, files an information form, maintains books and records as the SEC may require, and cooperates with any request for information or examination by the SEC staff. The proposed information form would be required to be filed electronically, updated at least annually, in such form as determined by the SEC, and would be publicly available in a searchable format and must contain at least the following:

- The name and current address of (i) each natural person who is a beneficial owner of the investment company;[1] (ii) any company with an ownership interest in the investment company; and (iii) the primary accountant and primary broker used by the investment company;
- An explanation of the structure of ownership interests in the investment company;

- Information on any affiliation that the investment company has with another financial institution;
- A statement of any minimum investment commitment required of a limited partner, member or other investor in the investment company;
- The total number of any limited partners, members or other investors in the investment company; and
- The current value of the assets of the investment company and any assets under management by the investment company.

Investment Adviser Registration Implications

Historically, investment advisers with fewer than 15 clients were not required to register with the SEC under the Advisers Act. Rule 203(b)(3) of the Advisers Act provides:

> *The provisions of subsection [203](a) [requiring investment advisers to register] shall not apply to any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under title I of this Act. . . .*

For these purposes, a private investment entity would generally be counted as a single client pursuant to Rule 203(b)(3)-1 under the Advisers Act. Many private equity sponsors have relied on this rule to avoid registration with the SEC and the burdens associated therewith.

In 2006, the SEC adopted a rule requiring many investment advisers to hedge funds to register under the Advisers Act. The rule created an exception from Rule 203(b)(3)-1, requiring an investment adviser to "look-through" a private investment entity to its investors as "clients" of the investment adviser if the private investment entity permitted redemption of interests within two years. The rule was vacated by the U.S. Court of Appeals for the District of Columbia in *Goldstein v. SEC*.

The "Hedge Fund Transparency Act" would require registration of private equity funds and other private investment entities in addition to hedge funds.

As noted above, the HFTA would require private investment entities having $50 million or more in assets to register with the SEC under the 1940 Act. The effect of such registration could be that the investment adviser would no longer be able to rely on Rule 203(b)(3) for exemption from registration under the Advisers Act, even if it has fewer than 15 clients, because it would be advising a registered investment company.

On January 27, 2009, Representatives Michael Capuano (D-MA) and Michael Castle (R-DE) introduced a bill in the U.S. House of Representatives titled "The Hedge Fund Adviser Registration Act of 2009," which would amend the Advisers Act by removing the exception from registration for those investment advisers with less than 15 clients.

Other Changes

The HFTA also includes an important variation from current Section 3(c)(7), the exception from the 1940 Act applicable to private investment funds that are owned exclusively by qualified purchasers and not engaged in a public offering. Proposed Section 6(B) states:

> *For purposes of this paragraph and paragraph (7), beneficial ownership . . . by a company shall be deemed to be beneficial ownership by one person, except that, if such company owns 10 per centum or more of the outstanding voting securities of the issuer, and is or, but for the exception provided for in this paragraph or paragraph (7), would be an investment company, the beneficial ownership shall be deemed be that of the holders of such company's outstanding securities (other than short-term paper) of such company. . . .*

Although this is how Section 3(c)(1) currently works for purposes of counting beneficial owners, Section 3(c)(7) does not currently contain a similar "look-through" with respect to an entity owner. As a result, under the HFTA, an entity having more than $25 million in investment assets, but relying on current Section 3(c)(1) (with not more than 100 beneficial owners of its securities and not engaged in a public offering), would no longer qualify as a qualified purchaser if it acquires beneficial ownership of more than 10% of a private investment entity relying on Section 3(c)(7) (e.g., a fund of funds) unless each of its beneficial owners are qualified purchasers.

Lastly, the HFTA would require that private investment entities establish anti-money laundering ("AML") programs, including reporting of suspicious transactions. The USA Patriot Act of 2001 imposed anti-money laundering programs on all "financial institutions", which included investment companies, investment banks and broker-dealers but not unregistered investment companies. In 2002, the Department of the Treasury attempted to extend the AML program to unregistered

investment companies, but the proposed regulations were never adopted and were withdrawn last year.

An anti-money laundering program would likely require a private investment entity sponsor to engage in a due diligence, know-your-customer type review of each investor, and to file suspicious activity reports in certain circumstances.

The HFTA has been referred to the Senate Banking Committee. If passed by the Senate and the House of Representatives, and signed into law by the President, the SEC would have 180 days to issue such forms and guidance as is necessary to implement the intention of the HFTA. We will continue to monitor the status of the HFTA and the Hedge Fund Adviser Registration Act of 2009, and we will keep you informed of future developments and other proposals relating to the regulation of private investment entities.

1 Senators Grassley and Levin indicated on February 5, 2009 that the HFTA would only require the disclosure of beneficial owners who receive fees from the investment company.

Too Clubby?

By Germaine Gurr (germaine.gurr@weil.com)

On December 15, 2008, a federal district court in Massachusetts refused to dismiss a class action lawsuit brought by various shareholders against a number of private equity firms, firms which, the shareholders claimed, "illegally colluded in their purchase of companies as part of [certain] leveraged buyout [transactions]" that took place between 2003 and 2008 and that totaled more than $2.5 billion.

The shareholders in that case, *Dahl v. Bain Capital Partners*, alleged that the private equity firms "conspired to pay less than fair value for [the companies they purchased], which in turn deprived such shareholders of the true value of their shares upon the sale" of those companies. The shareholders did not claim that club deals alone were illegal; however, they did claim that the firms' agreements with each other with respect to those deals were. Specifically, the shareholders alleged that the firms violated US antitrust laws because they entered into club deal agreements in order to maintain control over both the leveraged buyout market and the acquisitions in question.

Upon reviewing the evidence provided by the shareholders, the court in *Dahl* rejected the firms' motion to dismiss the class action lawsuit because it found that "the presence of the same [private equity] firms in multiple transactions tie[d] the [private equity] firms together." "This overlap in firms," the court continued, "coupled with the shareholders' allegations that the [private equity] firms conspired to prevent open, competitive bidding for the target companies, 'plausibly suggest[ed]' an illegal agreement" under US antitrust laws. Such "plausible suggest[ion]," the court concluded, was sufficient to allow the shareholders' class action lawsuit to move forward.

The *Dahl* court did not make any final decision with respect to whether illegal agreements in fact existed between the private equity firms. Rather, whether the firms in fact violated US antitrust laws will be determined at trial. Nevertheless, its refusal to dismiss the class action lawsuit undoubtedly creates some uncertainty for private equity sponsors in future club deals. Moreover, the *Dahl* decision runs counter to a decision handed down last February by a federal district court in Washington, which dismissed a similar antitrust claim brought by various shareholders of WatchGuard Technologies Incorporated against two private equity firms that purchased WatchGuard.

There, as in the *Dahl* case, the shareholders claimed that the firms' agreement to combine forces in order to acquire WatchGuard was anticompetitive conduct that violated US antitrust laws. Unlike the *Dahl* court, however, the Washington court ruled in favor of the firms' motion to dismiss the shareholders' case. Specifically, the Washington court did not find that the firms' agreement to join forces to purchase WatchGuard alone was sufficient evidence that they violated US antitrust laws. Moreover, unlike the Massachusetts court in *Dahl*, the Washington court found that nothing prevented either another bidder from making a higher bid for WatchGuard or the shareholders from voting to reject the

acquisition of the company by the private equity firms. As the court noted, "[t]he illusion of market power arose not from [the private equity firms'] anticompetitive conduct, but from the lack of market interest in WatchGuard."

The *Dahl* class action suit is now being litigated in the federal district court in Massachusetts. The outcome of the trial may provide guidance to private equity sponsors as to what behavior, if any, by sponsors in future club deals may violate the antitrust laws.

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