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Jersey: Private Equity

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The aim of this guide is to provide its readers with a pragmatic overview of the private equity law across a variety of jurisdictions.

This chapter of the guide provides information about the current issues affecting private equity practice in Jersey and addresses topics such as mergers and acquisitions, management incentive schemes and debt financing, as well as insight and opinions and any upcoming legal changes planned.

What proportion of transactions have involved a financial sponsor as a buyer or seller in the jurisdiction over the last 24 months?

M&A transactions in Jersey tend to fall into two broad categories: large cross-border or international transactions, commonly involving the United States, the United Kingdom or other international financial centres, in which either the acquirer or the target entity have a Jersey element to their corporate structure, and local M&A deals in which a Jersey-based and operating business is acquired.

Precise data on M&A transactions in Jersey is not easily available, but in our experience a very significant majority of international transactions with a Jersey element involve financial sponsors, either as buyers or sellers. Financial sponsors acquiring or investing in a business will commonly have all or part of their acquisition "stack" of companies incorporated in Jersey. This is driven mainly by the flexibility Jersey company law affords, especially in relation to distributions and returns of capital, within a familiar English company law-based system that can also offer tax neutrality (though most private equity acquisition stacks are tax resident onshore). Large corporates will often have Jersey entities as part of their group structure for similar reasons.

The local M&A market has for more than a decade seen high levels of investment from financial sponsors, particularly in the financial services sector, with a significant number of sponsors acquiring or investing into Jersey-based service providers. While there has been significant consolidation in recent years, and a corresponding reduction in the number of attractive target companies, there are still cases of financial sponsors acquiring or investing into independent/manager-owned service providers. However, the more notable recent transactions in this sector have been bolt-on acquisitions by large, international sponsor-backed service providers, with targets including both listed companies and other financial sponsor-backed businesses, e.g. the General Atlantic and Hg-backed Gen II acquiring Crestbridge, and the Genstar Capital-backed Apex Group acquiring Sanne Group PLC.

What are the main differences in M&A transaction terms between acquiring a business from a trade seller and financial sponsor backed company in your jurisdiction?

Differences in transaction terms tend to track those seen in other jurisdictions, especially in England and Wales. Such differences are largely the result of financial sponsor sellers needing to achieve a "clean exit" from the asset following a disposal, in order to return capital to their Limited Partners. As in other jurisdictions, the warranties given by trade sellers and financial sponsor sellers differ, with sponsors commonly giving only title and capacity warranties (with management giving business warranties and bearing the risk of any claim under such warranties, normally backed by W&I insurance), whilst trade sellers will usually give more comprehensive warranties. Financial sponsor sellers also tend to insist on locked-box pricing mechanisms, with completion accounts mechanisms being seen only where the seller is a trade seller, and even then fairly infrequently where there is a sponsor buyer.

It is worth noting however that in the local Jersey M&A market there is a less of a delta in transaction terms as between those involving a trade seller and those involving a financial sponsor. Risk allocation as a whole tends to be more seller friendly in Jersey, which can be attributed to the more limited number of suitable target companies in the jurisdiction.

On an acquisition of shares, what is the process for effecting the transfer of the shares and are transfer taxes payable?

A transfer of shares is effected via a stock transfer form, signed by the transferor (and where the shares are unpaid shares, the transferee). Shares are transferred to the transferee at the point at which the transferee is entered into the register of members of the relevant company. Completion board minutes of the transferor will typically approve the transfer and execution of the STF. A share certificate is issued to the transferee following the transfer, with the transferor's share certificate being cancelled.

Stamp duty is not payable on a transfer of shares in Jersey (subject to limited exceptions for Jersey companies that hold local real estate).

How do financial sponsors provide comfort to sellers where the purchasing entity is a special purpose vehicle?

Comfort is commonly provided via equity commitment letters, debt commitment letters and other funding undertakings that create binding obligations on the relevant parties to fund the special purpose vehicle for the acquisition. Equity commitment letters and other such instruments are generally only seen on transactions where a financial sponsor buyer or seller is using a Jersey acquisition stack, with local M&A deals generally not being of the size to warrant their use.

How prevalent is the use of locked box pricing mechanisms in your jurisdiction and in what circumstances are these ordinarily seen?

As mentioned above, locked box mechanisms are used in almost all transactions involving financial sponsor sellers or buyers, with the terms of the mechanism mirroring those seen in the jurisdiction where the relevant financial sponsors

involved in the transaction are based, commonly the United States or the United Kingdom. As in other jurisdictions, the price certainty and clean break afforded by using such mechanisms is the primary reason for their use.

Local Jersey M&A transactions more commonly feature completion accounts mechanisms, with accurate valuation and determination of consideration being favoured over price certainty in this context.

What are the typical methods and constructs of how risk is allocated between a buyer and seller?

Terms concerning pricing and payment of consideration are the primary methods of risk allocation. The price agreed in relation to an asset will reflect the risks that are being acquired with it. As referred to above, locked box mechanisms – where a price for an asset is agreed at signing based on a specified set of financial accounts, with no further adjustment to that price permitted unless any "leakage" (against which the buyer is indemnified) occurs – are the most common.

Mechanisms concerning how and when the purchase price is paid are also used to allocate risk. Most deals involving a financial sponsor buyer or investor include some element of deferred consideration or earn-out. Deferred consideration mechanisms often include a right to set-off any warranty claims against any outstanding deferred consideration or earn-out payments due, and claw-backs are on occasion seen.

Many sponsor-backed acquisitions and investors also include some degree of manager and, less frequently, seller participation in the acquisition structure (either by way of roll-over or buy-in). This not only acts as a performance incentive but also shifts some of the risk to the management team and/or seller.

Warranties and indemnities also play a critical role in risk allocation. However, we are seeing a move away from buyers insisting on specific indemnities in relation to material identified issues or risks in favour of price- and consideration-based risk allocation of the types mentioned above, or remediation being included as a condition precedent to completion.

How prevalent is the use of W&I insurance in your transactions?

International transactions with a Jersey element will commonly feature the use of W&I insurance, as is the norm elsewhere. W&I insurance is not standard market practice for local Jersey M&A transactions, with the size and risk profile of those transactions generally not warranting the use of such policies, though it does feature in a significant minority of local M&A transactions (perhaps 10 to 20 per cent, depending on the sector).

How active have financial sponsors been in acquiring publicly listed companies?

As has been the case worldwide, financial sponsors have been very active in acquiring publicly listed Jersey companies in recent years, particularly Jersey-registered companies listed in London, which have been seen as comparatively undervalued on the public markets and as being especially attractive to US sponsors given the strength of the dollar against the pound. A significant majority of public M&A transactions in Jersey have involved sponsors or sponsor-backed companies. Examples include Apollo's acquisition of The Restaurant Group PLC, Permira's acquisition of Mimecast PLC and Charterhouse's acquisition of the Tarsus Group PLC.

Many listed companies are Jersey-registered, particularly on UK and North American stock exchanges. It is worth noting that the City Code on Takeovers and Mergers applies to offers for Jersey-registered companies where any of that company's securities are admitted to trading on a UK regulated market, UK multilateral trading facility or any stock exchange in the Channel Islands or Isle of Man, and in other specific circumstances.

Outside of anti-trust and heavily regulated sectors, are there any foreign investment controls or other governmental consents which are typically required to be made by financial sponsors?

Jersey does not have any foreign direct investment controls or other governmental consent requirements outside of anti-trust and heavily regulated sectors. For local operating business, to the extent local regulatory consents are required, those requirements apply equally to all types of acquirers and investors.

How is the risk of merger clearance normally dealt with where a financial sponsor is the acquirer?

Merger clearance in Jersey is regulated by the Jersey Competition Regulatory Authority (JCRA). Three share of supply threshold tests determine if consent is required for a transaction. If a transaction meets any one of these supply tests, prior approval from the JCRA is required to complete the transaction, without which any transfer of title to shares in Jersey companies and the title of any property in Jersey is void (i.e. Jersey's anti-trust regime is mandatory and cannot be "closed over").

The seller and the financial sponsor will usually agree on whether clearance from the JCRA is likely to be required, with clearance being included as a condition precedent to completion in the transaction documents. A mutual obligation on each of the parties to cooperate towards obtaining the clearance will also be included, with parties typically applying for clearance jointly.

Have you seen an increase in (A) the number of minority investments undertaken by financial sponsors and are they typically structured as equity investments with certain minority protections or as debt-like investments with rights to participate in the equity upside; and (B) 'continuation fund' transactions where a financial sponsor divests one or more portfolio companies to funds managed by the same sponsor?

Consistent with global trends, Jersey has seen an increase in both minority investment and continuation fund transactions. Minority investments have tended to be structured as equity investments, with a number of high-profile minority investments being made in recent years, including the Warburg Pincus investment in Aztec Group.

Continuation fund transactions have also seen a marked increase in recent years as financial sponsors seek to provide liquidity to their Limited Partners. Jersey, as an international fund domicile of choice for many leading financial sponsors, is seeing an increasing number of such vehicles and related transactions. Intra-portfolio transactions, where one portfolio company held by a financial sponsor is transferred to another portfolio company of that sponsor, have also started to feature more frequently.

How are management incentive schemes typically structured?

As in the UK and other jurisdictions, management incentive schemes are typically structured with sweet equity being allocated to management and vesting on a set schedule over the life of the investment, though often not vesting fully until exit is achieved. The sweet equity attracts a preferential return once the hurdle created by any loan notes or preference shares which rank above them in the structure is cleared. Growth shares are also sometimes seen in MIP structures, particularly so in recent years, and ratchet provisions which increase the equity allocated to management upon meeting certain performance targets are common. Cash bonus programs are seen very rarely in Jersey. Any incentive scheme will be subject to the good and bad leaver provisions included in the articles of association of or the investment/shareholders agreement relating to the relevant entity.

Are there any specific tax rules which commonly feature in the structuring of management's incentive schemes?

Jersey itself has no specific tax rules that impact the structuring of management incentive schemes (beyond local tax considerations for Jersey residents), indeed management incentive schemes often feature an EBT or other pooling vehicle that is established in Jersey given the tax neutrality of the jurisdiction. Management incentive schemes seen in Jersey transactions and structures tend to be influenced by the tax laws of the jurisdiction in which the relevant managers are resident. Given the international nature of many Jersey company structures and the individuals who manage them, the international tax rules that feature in the structuring vary.

Are senior managers subject to non-competes and if so what is the general duration?

As in other jurisdictions, managers are typically subject to non-competes of around one to three years in length. Employment contracts for managers tend to feature non-competes around 12 months in length, whereas non-competes imposed on selling manager shareholders under an SPA, or incoming manager shareholders under a shareholders or investment agreement, might be closer to three years. Non-competes tend to cover businesses that are both of a similar nature or supplying the same market and operating in the same geography, which in the context of local Jersey M&A deals is often the Channel Islands as whole.

How does a financial sponsor typically ensure it has control over material business decisions made by the portfolio company and what are the typical documents used to regulate the governance of the portfolio company?

Control over decision making at the portfolio company level is typically ensured by a range of protections built into the articles of association of the portfolio company (or relevant holding company) and into a shareholders or investment agreement that governs the relationship between the various investors in the portfolio company.

Typically the articles of association of the Topco which sits above the portfolio company (and through which the sponsor and other investors hold their interest) will specify the voting rights that attach to each class of share in the holding company. The control afforded by the voting rights in effect flows down the acquisition stack to the portfolio company level. In investments other than minority investments, the sponsor will have shares that represent more than the two-thirds majority (which can be increased) needed to pass a special resolution, giving them effective control. The articles may specify certain matters that require further shareholder votes or consents outside of those matters which require it as a function of statute.

A shareholders or investment agreement at the Topco level will provide an additional layer of control. Elements such as a reserved matters / investor consent regime (stipulating matters that must be decided on / consented to by the shareholders rather than the directors), information rights (commonly to periodic reporting and business updated from the management team) and director appointment and removal rights (so that control may be exercised at board level) are all common features of such agreements. Certain rights in the shareholders agreement will commonly be "baked into" the articles of association, with others being cross-referenced; Jersey law affords significant discretion to investors as to how much material must be included in the articles (which are public) rather than the shareholders/ investment agreement (which is not).

Is it common to use management pooling vehicles where there are a large number of employee shareholders?

Pooling vehicles such as employee benefit trusts, mandatory nominee structures or other such arrangements are very common where employee or management shareholders feature in a structure. Employees / managers do in some instances hold their interests in a structure directly, but given the administrative, tax and other incentives for using a pooling vehicle this is less commonly seen.

What are the most commonly used debt finance capital structures across small, medium and large financings?

Debt financing transactions tend to track those seen in other jurisdictions, especially in England and Wales.

Small financings will typically see a single bi-lateral secured term loan that is made to the "Bidco", which then uses the funds to acquire the target company. Sponsors may also fund a smaller acquisition entirely out of equity, before arranging financing after completion of the transaction.

Medium scale financings will typically involve a senior and a secondary tranche of financing, which facilities are often provided by a syndicate of lenders.

Large scale financings will often see a large lender group financing through a number of tranches or facilities, including a senior tranche through to revolving, mezzanine and payment-in-kind tranches. High-yield bond issues are also being seen more frequently after having been less popular over the past few years.

Is financial assistance legislation applicable to debt financing arrangements? If so, how is that normally dealt with?

There is no financial assistance legislation in Jersey.

For a typical financing, is there a standard form of credit agreement used which is then negotiated and typically how material is the level of negotiation?

Where there is a United Kingdom nexus, credit agreements tend to be based on existing leveraged finance precedents or on the Loan Market Association documents. Jersey companies are commonly also used as financing vehicles in United States sponsor transactions, in which case the usual forms of United States debt documents will be used.

Agreements taking security over Jersey situs assets have specific terms and drafting relating to the taking of such security, so are bespoke for the jurisdiction (as tailored to reflect the commercial terms).

What have been the key areas of negotiation between borrowers and lenders in the last two years?

Again, in Jersey this tracks the key areas of negotiation in other jurisdictions, in particular the most heavily negotiated points are typically loan pricing, financial definitions, applicable financial and maintenance covenants (and how the metrics those covenants concern are calculated) and restrictions around incurring any further debt and general covenants concerning the operation of the underlying businesses.

Have you seen an increase or use of private equity credit funds as sources of debt capital?

Consistent with the trend in the industry as a whole, we have seen increasing numbers of transactions supported by private credit lenders, which have emerged as contenders to the traditional syndicated lenders.

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