The Legal 500 Country Comparative Guides

Ireland: Private Equity

This country-specific Q&A provides an overview of private equity laws and regulations applicable in Ireland.

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

There has been a marked increase in transactions involving financial sponsors in the Irish market over the last 24 months and most notably since the start of 2020. In 2019, financial sponsors were involved in 39 of 173 transactions undertaken in Ireland, approximately 23% of the overall market. Notwithstanding that the value and volume of M&A transactions generally has fallen in Ireland during 2020, the volume of transactions involving financial sponsors has increased to its highest level in seven years. During the first three quarters of 2020, 40 of 105 transactions undertaken involved a financial sponsor, representing approximately 37% of the overall market. While 2019 marked a continuation of a gradual, but significant, increase in the influence of financial sponsors in the Irish M&A market, there has been an acceleration of this trend in 2020. During 2020 some high profile acquisitions were undertaken by financial sponsors including, TowerBrook Capital Partners' acquisition of CarTrawler and the sale by Bregal Milestone of Arkphire, an Irish information technology services company.

Technology, Media and Telecoms, Financial Services and Healthcare remained active this year, with increased deal volume in these sectors. Blackstone Group's portfolio company Phoenix Tower acquired Emerald Tower (an Ireland-based operator of wireless towers) from eir, the Carlyle Cardinal Ireland Fund disposed of its interest in AA Ireland and private equity-backed French care group Emera acquired a majority stake in Virtue Group (a greater Dublin based operator of residential care homes) in a sector which has seen strong levels of deal activity in recent years. Another noticeable trend we have seen recently, particularly since the onset of COVID, is the increase in the number of bolt-on acquisitions being undertaken by corporates backed by financial sponsors, including Insight Partners acquisition of Statistical Solutions Limited, an Irish data science and business analytics company and the acquisition by Modern Hire, a portfolio company of The Riverside Company, of Sonru Limited, a global leader in video interviewing technology.

We expect financial sponsors and their portfolio companies to continue to play a significant part in Irish M&A activity during 2021 and beyond.

2. **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?**

The two most significant differences are: (i) the pricing mechanism used, with trade sellers typically favoring a completion accounts mechanic whereas financial sponsors tend to have a preference for pricing the transaction on a locked box basis and (ii) the manner in which contractual risk and the related warranty protection is dealt with in the transaction documents, the use of W&I insurance being much more prevalent with financial sponsors than trade sellers.

The locked box concept involves the seller providing, and generally warranting, a balance sheet for the business being sold at a point in time prior to completion, but generally as close as practicable to the completion date. This balance sheet is used to fix the equity price in respect of the cash, debt and working capital actually present in the target on the relevant locked box date. The resulting equity price is written into the agreement as an amount and paid by the purchaser at completion. This price is not adjusted further following completion, save for specific indemnities provided by the seller to the purchaser in respect of unauthorised leakage of value from the target group between the locked box date and completion of the transaction. As a result, the purchaser effectively takes on the financial risks and rewards of ownership of the business from the locked box date.

The other main difference between trade sellers and financial sponsors is the manner in which contractual protection is offered under the main transaction documents and the use of W&I insurance. Financial sponsors typically only provide warranties in relation to legal title to their shares, capacity to enter into the transaction documents and solvency. The management team who hold shares in the target will generally provide commercial warranties relating to the business, but will only be “on risk” for the cash (or a portion of it) they are taking out of the deal, which will typically only be a small percentage (up to 20%) of the overall sale price. The “gap” in cover between the management’s proceeds and the full purchase price is now regularly addressed by the use of W&I insurance. In the case of trade sellers, the selling shareholders will typically provide title and capacity warranties and also the commercial warranties relating to the business.

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

The transfer of shares in an Irish company must be (i) evidenced in writing by executing a share transfer form and (ii) signed by the transferor and, in the case of shares which are not fully paid, or an unlimited company, the transferee. Where the target is an Irish incorporated company, an Irish stamp duty cost will generally arise upon the acquisition of the shares, at a rate of 1% on the consideration paid (or market value, if higher), depending on how the investment is structured. For certain real estate holding companies, a higher stamp duty rate of 7.5% may apply.

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

On larger transactions, financial sponsors tend to provide the seller with equity commitment letters which are supported by legal opinions. Equity commitment letters are usually structured as an irrevocable commitment given by the fund to the acquisition vehicle pursuant to which the financial sponsor commits itself to invest certain funds in the acquisition vehicle for the purpose of either paying the purchase price or, if closing does not occur as a result of the purchaser’s breach, a damages claim. On smaller transactions, financial sponsors may opt to provide comfort to the sellers through certain fund representations made in the share purchase agreement.

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

Locked box mechanisms are used on the majority of PE exits as it offers purchase price certainty from the outset, greater control over financial information, fixing the date of economic transfer of the target before completion and prompt distribution of sale proceeds to sellers after completion. While locked box mechanisms were previously used on virtually all auction deals, since the onset of COVID there has been an increase in the use of earn outs, where the parties have differing views on future company performance.

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

The allocation of risk between a buyer and seller is very deal specific in Ireland. However, the current market for sale terms remains, on balance, relatively seller friendly, particularly in those markets which have been less impacted by COVID – in particular, Pharmaceuticals, Medical and Biotech and Technology, Media and Telecommunications.

Financial sponsor sellers will typically assume limited contractual liability under a share purchase agreement in relation to operational matters. Financial sponsor buyers will expect title and capacity warranties and also customary commercial warranties from sellers, save in respect of financial sponsor sellers, where the position outlined in paragraph 2 above is generally accepted.

The most important risk allocation method is the locked box mechanism, which passes all economic risks and rewards following the effective date to the buyer. Financial caps on seller liability for breach of warranty claims of between 25% and 50% of the overall purchase price is common on mid-market and higher value transactions, whereas historically market practice in Ireland would have been for 100% of the overall purchase price to be “on risk” for breaches of warranty. In Ireland, a separate tax deed is typically used to allocate tax risk between a buyer and seller.

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

The increased use of W&I insurance has been a major development in the structuring of M&A transactions in Ireland in recent years. This has been particularly true over the last two to three years as a greater proportion of businesses which have been acquired by financial sponsors in recent years are now being brought to market, with the use of W&I insurance being a common feature of such transactions. The use of W&I insurance is particularly common on share sales where the underlying asset is property or energy related.

8. **How active have financial sponsors been in acquiring publicly listed companies and/or buying infrastructure assets?**

Public to private transactions by financial sponsors are rarely seen in the Irish market. There were no such transactions in 2020 and there was one such transaction in 2019, the take private of financial services firm IFG Group by UK fund Epiris. A public-to-private transaction is regulated by the provisions of the Irish Takeover Panel Act 1997 (as amended), the Irish Takeover Rules 2013 (Rules) and the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006. The Rules regulate the conduct of takeovers of Irish companies listed on certain stock exchanges. The Irish Takeover Panel oversees the application of the Rules to specific transactions. Financial sponsors (ie, unlisted funds with project equity investment mandates) are particularly active in the Irish infrastructure market. We see strong interest from financial sponsors in social, transportation, waste, digital and energy (particularly renewables and interconnection) infrastructure in Ireland. Key players in the Irish market from an equity investment perspective include Macquarie, AMP Capital, ISIF, DIF, John Laing, Equitix and Partners Group.

9. **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?**

In Ireland, draft legislation is underway in the form of the Investment Screening Bill 2020 to introduce powers for the Irish Government to review investments by non-EU investors in sensitive industries that may give rise to national security concerns. According to an Irish Government press release, the proposed legislation will empower the Department of Enterprise, Trade and Employment to investigate, authorise, condition, prohibit or unwind foreign investments into Ireland by non-EU investors, based on a range of security and public order criteria. However, the draft legislation has not yet been published and therefore the potential impact on the M&A market is not yet clear, in particular, it is not clear what type of transactions are likely to be subject to review (and the extent of that review). It is expected that the Irish approach to implementation will seek to maintain Ireland’s attractiveness as a location for inward investment, while reflecting the need to take into account national security and public order considerations in certain strategically important sectors. For now, Ireland is to comply with the cooperation and information sharing requirements under the EU Investment Screening Regulation.

Outside of the above and certain mandatory regulatory approvals and governmental consents in specific regulated sectors such as healthcare, financial services and media, no other controls apply to financial sponsors.

10. **How is the risk of merger clearance normally dealt with where a financial sponsor is**

the acquirer?

In Ireland, competition clearances are, where applicable, a condition precedent to completion, leading to a split signing and completion pending approval from the Competition and Consumer Protection Commission. The risks of competition clearance are typically passed on to the purchaser by the use of a “strict hell or high water” clause, which may include an obligation on the purchaser to make any required divestments or litigate in the event the transaction is challenged from a competition perspective.

11. **Have you seen an increase in 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?**

Minority investments undertaken by financial sponsors have increased in Ireland in recent years and this is something we expect to see continue as dedicated minority funds enter the market, both local and international. There are a variety of capital structures used, ranging from ordinary equity investments with certain control rights, preferred equity or debt-like structures with limited governance rights but with the ability to participate in equity returns. While not a major feature of the Irish market in recent years, mezzanine debt and convertibles have also become more common.

12. **How are management incentive schemes typically structured?**

A common management incentive scheme in Ireland is granting the managers of the selling entity direct equity interests in the purchaser’s acquisition vehicle. The positive aspects of this structure are that the equity can result in gains being subject to capital gains tax treatment when the managers roll-over into the purchaser structure upon their disposal of shares in the target company. This can be contrasted with the tax treatment that applies to share option, exit bonus or phantom share schemes which attract higher rates of tax for the individuals and social security contributions for the portfolio company which employs them.

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

In general, whilst share incentivisation is common in Ireland, the tax treatment of most forms of share incentivisation is not particularly advantageous for employees/directors based in Ireland, with marginal rates of income tax, universal social charge and social security generally applying on any benefits obtained (subject to the comments below). However, if the shares that the employees receive qualify as “restricted shares” (under Irish tax rules), there could be a material abatement of up to 60% of the taxable value of the shares for Irish tax purposes (subject to certain qualifying conditions being met). This is, potentially, very favorable for employees/directors. Ireland also introduced a “Key Employee Engagement Programme” (“KEEP”) which provides for an exemption from income tax, universal social charge and social security arising on the exercise of a qualifying share option to acquire shares in a qualifying company in the SME sector, provided certain conditions are satisfied.

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

Senior managers in Ireland are typically subject to non-compete clauses. While the standard duration of non-compete clauses in an employment contract for senior executives is typically between 6 and 12 months in duration, in a share purchase agreement, the non-compete period for sellers (which may include senior managers) can be up to three years in duration when the transfer of the undertaking includes the transfer of customer loyalty in the form of both goodwill and know-how. Like in many other jurisdictions, the balance between restraint of trade and protection of legitimate business interests makes enforceability fact specific.

15. **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?**

Including specific covenants in a shareholders' agreement (or investment agreement) is how a financial sponsor will typically ensure it has control over material business decisions made by the portfolio company. The main investment agreement will typically allow the financial sponsor to control the composition of the group's board of directors, include veto rights over material business decisions and oblige the management team to submit regular financial and event driven reporting to the sponsor for the purpose of monitoring its investment. Alternatively, or in parallel with a shareholders' agreement, a financial sponsor will hold the majority of voting rights in the target entity to ensure control over material business decisions.

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

Typically, the management team of between four and six senior executives will individually invest for ordinary shares ("sweet equity") in their own names. Occasionally, where there is a larger pool of management investing in the sweet equity pot, this will be structured through a NomineeCo. Any arrangements put in place with the management team will be subject to a thorough tax analysis to ensure the most beneficial outcome for the participants on any exit.

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

Capital financings in Ireland typically take the form of either long-term (i.e. four to five years plus one (or one plus one) year options to extend) or short-term loan facilities akin to a bridge that may be refinanced by a bond on larger financings. Revolving facilities are commonly made available for working capital purposes. It is not uncommon for medium to large financings to have a mezzanine element. With multiple alternative credit providers having entered the Irish market in recent years, venture capital financing has increased, particularly in the fin-tech and pharmaceutical industries. The increase in activity in the Irish property sector – which has been significantly impacted by the onset of COVID – has also resulted in the use of alternative financing structures, such as note issuance programmes, which enable investors who might not otherwise be permitted to lend into Ireland to build up market share. We are also seeing continued growth in alternative credit providers, as well as more traditional lenders, offering finance through investment funds. This often involves the provision of secured or unsecured subscription (or capital call) facilities to bridge capital calls to investors, thereby improving the availability of working capital and/or investment finance.

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

Yes, it is unlawful for an Irish company to give any financial assistance for the purpose of an acquisition of shares in the company or, where the company is a subsidiary, in its holding company. There are however a number of exemptions, with the most common exemption being the carrying out of a whitewash procedure (known as a summary approval procedure), which approves and permits the form of assistance rendering it lawful. The Companies Act 2014 introduced an additional carve out against financial assistance where the company's principal purpose in giving the assistance is not to give it for the purpose of any such acquisition (the so-called "principal purpose test") or the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company (the so-called "incidental part test"), and, in each case, the assistance is given in good faith in the interests of the company. The summary approval procedure involves a number of steps, including the swearing of a declaration by all or a majority of the directors of the relevant company that, among other things, the directors have (following full inquiry) formed the opinion that the company will be able to pay or discharge its debts and liabilities in full as they fall due for a period of twelve (12) months following the giving of the financial assistance. Shareholder and board approvals are also required. Public companies and their private subsidiaries are not able to avail of the summary approval process and thus, unless the relevant financial assistance falls within one of the other more limited categories of exemption, it will not be permitted. Failure to comply with the prohibition on financial assistance is a criminal offence and any financial assistance (eg. guarantees, charges, etc.) granted in breach of the legislation is voidable.

19. **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?**

The Loan Market Association's standard form leveraged facility agreement is used for most medium to large corporate loan financings in Ireland. The level of negotiation on the terms of the LMA facility agreement will vary on a deal by deal basis but, as drafting often follows a pre-agreed term sheet, commercial issues are usually agreed at an early stage of a transaction. The LMA form requires a number of Irish law related changes (particularly in relation to insolvency and tax), however, these amendments do not tend to be heavily negotiated. Unlike the UK or US, the Irish market is more traditional in its approach to drafting and the lenders' counsel will usually draft the loan agreement, although the strength of the sponsor can very occasionally dictate the ability of a borrower to present a "first draft" of the loan agreement.

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

Since March 2020, and throughout 2020, a significant proportion of loans, particularly those exposed to the retail, hospitality, tourism, aviation and student accommodation sectors, have undergone a mix of payment breaks, financial covenant waivers, covenant deferral periods and longer-term covenant re-sets. In our experience, lenders are working closely with their borrowers in a constructive manner to find longer term solutions for both sides. We expect this trend to continue into 2021, although at a reduced level, with the level of longer term waivers and amendments being very much dependent on market trends in the relevant sectors.

Prior to March 2020, financial covenants (and cures to any covenant breaches), were also a key area of negotiation, along with assignment and transfer provisions (and, in particular, the scope of white / black lists). Accordion facilities, options to extend the term and the mechanics around exercising these options also tend to be closely scrutinised. In contrast to the UK, the local Irish market has not embraced cov-lite transactions, although in some pre-March 2020 deals we were starting to see a relaxation of permissions around the use of cash.

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

There has been a sharp increase in the number of alternative credit funds and private equity investors active in the Irish market in recent years. In the real estate sector in particular, the relatively conservative lending practices of the traditional Irish banks has resulted in many Irish real estate developers and investors seeking capital from alternative sources. In the SME sector, the Irish government has developed a number of initiatives to ensure that the supply of credit in the market (from bank and non-bank sources) is sufficient to meet the existing and future funding needs of SMEs. The Irish government has invested, via the Ireland Strategic Investment Fund, in a number of private equity credit funds who provide debt capital to Irish SMEs. Although we have seen private equity credit funds lend through a variety of financing structures, typically funds are advanced via a secured loan or from the proceeds of a note issuance programme.