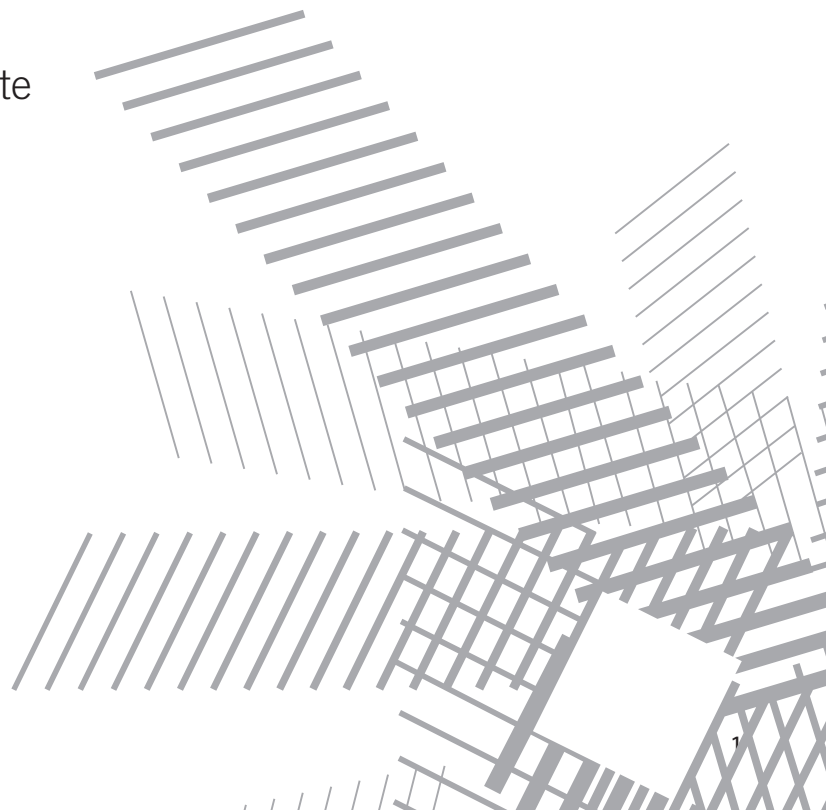


CLEAR THINKING

Australian Private Equity Market Update
2011



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Australian private equity market

Exits

The trend towards secondary sales is increasing in Australia, while IPO markets remain difficult.

Fund structures

The Australian Tax Office's pursuit of TPG has impacted on fundraising; however, alternative structures are being used successfully for new deals.

Fundraising

Domestic sponsors shifted offshore for fundraising but changes to the Australian superannuation industry may boost future investment over the long term.

Acquisitions

We expect to see more take-private deals in 2012 and market conditions will see the 'loan-to-own' acquisition strategy continue to emerge.

Leveraged finance

Recent terms and trends indicate that the Australian lending market is active. The proposed standardisation of intercreditor principles will help growth of the mezzanine debt market.

Introduction to the Australian private equity market

Tom Story
Partner, Co-Head of Private Equity

Welcome to this update on the Australian private equity market prepared by the Allens Arthur Robinson private equity team. This publication analyses some of the key issues, trends and developments that we have observed in advising on Australian private equity transactions in 2011. The six feature articles draw upon the expertise of our top-ranked M&A, funds, leverage finance, restructuring and tax lawyers.

In this introductory article, I look back on some of the trends that we have seen in the Australian private equity market in 2011, and comment on the outlook for 2012.

Time to clear the decks

Domestic private equity sponsors have been particularly active in 2011 in exiting investments in preparation for entering the tough fundraising market. Much of the recent exit activity has been driven by secondary buyouts, as IPO market conditions have remained difficult. The headline secondary deal of 2011 was the sale of accounting software business MYOB by Archer Capital and co-owner HarbourVest Partners to US sponsor Bain Capital for in excess of A\$1.2 billion. Archer Capital was also active in making secondary acquisitions, purchasing private hospital business, Health Care, from CHAMP Ventures and fast food business Quick Service Restaurant Holdings from Quadrant Private Equity. Partner Mark Malinas examines some of the key trends in the Australian private equity exit market in more detail in his article.

IPO window still shut...

Pacific Equity Partners portfolio company, Collins Foods, completed the largest private equity-backed IPO for two years, benefitting from the strong trading performance of ASX-listed comparable, Domino's Pizza. For the most part, however, the IPO window has remained largely closed for private equity assets, as domestic fund managers have continued to focus on the poor Australian Securities Exchange (**ASX**) trading performance of the Myer Group. The ASX has nevertheless provided exit opportunities for some assets via equity funding for listed acquirers. West Australian Newspapers raised A\$693 million via an entitlement offer in early 2011 to partially fund the acquisition of Seven Media Group from Seven Network and KKR. More recently, Super Retail Group raised A\$334 million via an entitlement offer to partially fund the acquisition of sporting goods retailer Rebel Group from Archer Capital. CVC Asia Pacific portfolio company Nine Entertainment also sold its 49 per cent shareholding in ASX-listed carsales.com for A\$562 million via an underwritten sell-down to institutional investors. Future private equity-backed IPOs are likely to require more substantial stakes being retained by the sponsor, perhaps with other features such as new investors being granted with call options over retained shares at the IPO issue price.

Allens news

Allens advised the Archer Capital-led consortium on its sale of MYOB Limited to Bain Capital, the largest private equity transaction of 2011 in the Australian market. Allens acted on Archer's initial take-private acquisition of MYOB in 2009.

Allens acted on other major secondary private equity deals during 2011 including advising Archer Capital on its acquisition of HealthCare Australia Pty Limited, the third-largest for-profit private hospital operator in Australia, from a CHAMP Ventures consortium.

Allens had key roles for buyers and sellers on key private equity exits during the year including acting for West Australian Newspapers on its A\$4.1 billion acquisition of Seven Media Group from KKR & Seven Network Ltd as well as advising the financiers to Bright Food on its acquisition of Manassen Foods from a consortium led by CHAMP Private Equity.

Allens had important roles for financiers to private equity buyers during the year, including advising the financiers to Archer Capital's acquisition of a controlling stake in V8 Supercars Australia and advising the financiers to PEP's joint venture investment in SCA Hygiene Australasia.

Allens advised on two major company restructures involving private equity acquisitions. We advised the security trustee and agent in relation to the A\$2.9 billion deleveraging of the Alinta Energy Group, including a debt-for-equity swap involving TPG Opportunities Partners, Oaktree Capital & Anchorage Advisers. We also advised the senior lenders to the Centro Properties Group on its proposed restructure and aggregation involving the sale of US assets to Blackstone, and the formation of a new listed Australian property fund.

Asian buyers not just interested in Australian resources

While the media focus has continued to be on mining and energy deals, Chinese and Japanese interest in Australian private equity assets has also been strong in 2011. PEP and Unitas Capital sold New Zealand-based beverage group Independent Liquor to Japan's Asahi Group for NZ\$1.53 billion, while China's Bright Food Group acquired a 75 per cent stake in Manassen Foods from CHAMP Private Equity for more than A\$400 million. Asian interest is also being targeted as a potential exit route for new private equity acquisitions of soft commodity assets. We expect to see more investments in 2012 in Australian agriculture and livestock assets, following several deals in 2011, including Archer Capital's purchase of dairy business Brownes Foods.

Don't forget your passport

In 2011, several significant Australian limited partners, such as Victorian Funds Management Corporation and UniSuper, have been reported as deciding to cease making new commitments to private equity in favour of other asset classes. These moves have followed increasing pressure on local superannuation funds to reduce the management expense ratio of the funds they manage in the wake of the Cooper Review. This government-commissioned report into Australia's superannuation industry had a strong focus on making Australian superannuation investments more cost effective. As a result, domestic sponsors undertaking fundraising in 2011 have been heading offshore to seek a far greater proportion of their commitments from

offshore limited partners than was previously the case. In their article, Partner Susan Burns and Senior Associate Geoff Sanders examine the implications for foreign and domestic private equity sponsors of fundamental changes in Australia's A\$1.4 trillion superannuation industry, including the introduction of the 'MySuper' product. The Cooper Review and the withdrawal of some Australian limited partners from the asset class is also giving rise to an increasing flow of opportunities for global secondary investors in Australia.

A number of significant portfolios of Australian limited partner interests has been marketed to secondary investors in 2011 and we expect to see more deal flow of this type in 2012.

The leveraged finance market is healthy but for how long?

The terms offered by banks on deals during 2011 highlight the competitive tension that exists among lenders to private equity acquirers in the Australian market. It remains to be seen what impact the issues of European banks will have on available finance in the Australian market, but there are recent indications that non-European banks still see the Australian acquisition finance market as an opportunity. Partner Tom Highnam provides an overview of the key deals during 2011 in the Australian leveraged loan market and an update on the proposed standardisation of intercreditor principles that the market hopes will aid the growth of the mezzanine debt market in Australia.

'Loan to own' on the radar

Following the A\$2.6 billion Alinta Energy deleveraging transaction led by TPG in early 2011, 'loan to own' acquisition strategies are now clearly on the radar for opportunistic private equity sponsors. This development has been facilitated by the increasing willingness of Australia's trading banks to sell out of debt positions in distressed or over-leveraged assets. We believe that further opportunities will emerge in 2012 for private equity sponsors to team with hedge funds and other secondary debt trading participants to take control of Australian assets via the acquisition of debt. Partner Vijay Cugati explores this topic further and examines the Alinta Energy deleveraging transaction in detail.

P2Ps to return?

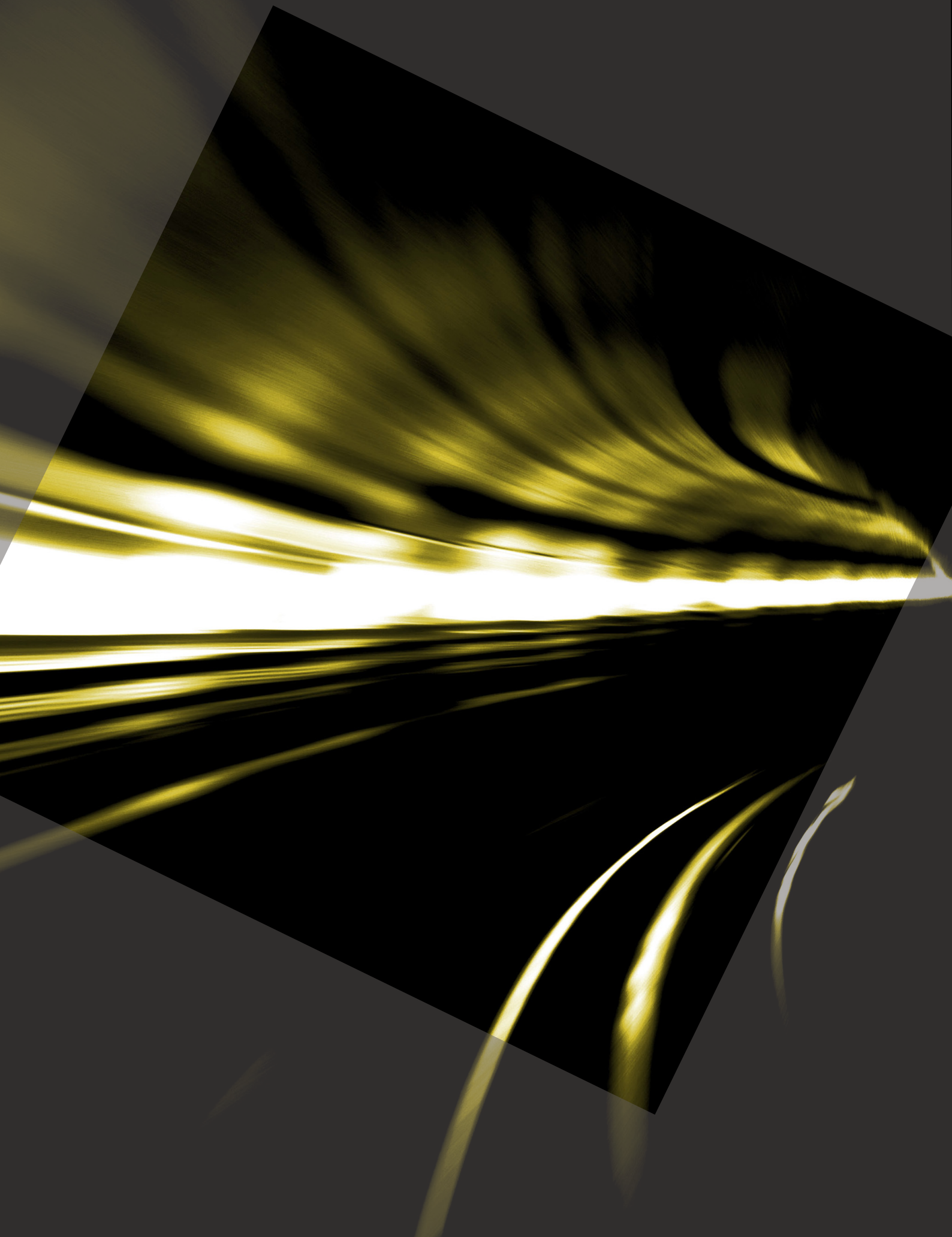
After the headline Healthscope transaction of 2010, 2011 has been a disappointing year for Australian public-to-private deals. Major US private equity sponsor Blackstone acquired distressed commercial real estate investment business, Valad Property Group, for A\$210 million. However, the board of services company Spotless Group rejected a A\$657 million take private proposal from Blackstone, and various other proposals, such as PEP's A\$270 million offer to salmon farming business Tassal Group, did not proceed after board rejections on value grounds. As offshore volatility continues to impact on ASX trading, we believe that attractive opportunities will remain in 2012 for private equity sponsors that are willing to approach listed companies. However, the degree of difficulty in completing these types of transactions will continue to be high.

Did someone mention tax?

Unfortunately, the Australian Taxation Office's (**ATO**) dogged pursuit of TPG in relation to the proceeds of its 2009 Myer Group float has continued to generate negative headlines both here and offshore for the Australian private equity industry. As Senior Associate Thomas McAuliffe explores in his article, a degree of taxation certainty can be achieved in various ways for foreign investors investing in Australian assets. Despite the existence of these structuring alternatives and the fact that the Myer issue has had limited impact on domestic sponsor investment structuring, the negative publicity has led foreign sponsors and limited partners to attach a higher degree of sovereign risk to Australian investments. This has impacted on transaction activity and sponsor fundraising. It is regrettable that, despite a number of submissions from the Australian Private Equity and Venture Capital Association, the Federal Government has failed to implement a comprehensive legislative solution to provide certainty to potential providers of offshore capital.

We hope that you will find the information in this publication thought-provoking and useful, and welcome the opportunity to discuss the issues in more detail.

Tom Story is an M&A and Capital Markets partner and co-head of Allens' Private Equity practice. In 2011, Tom advised on Archer Capital's sale of MYOB and acquisition of Health Care Australia and for trade-buyer West Australian Newspapers on its acquisition of Seven Media Group from KKR and Seven Network Ltd.



Leveraged finance trends in the Australian private equity market

Despite debt concerns in Europe and tighter liquidity in Asia, the appetite for Leveraged Buyout (LBO) financing from banks in Australia remains strong. Partner Tom Highnam analyses the recent transactions in the market to identify some of the trends for lenders to private equity.

Market analysis

The strength of the appetite for LBO financing from banks in Australia remains strong. This is evidenced by the following transactions listed below and the rumours of private equity interest in numerous current business sale processes indicates confidence in access to debt. There has been consistency in pricing and capital structuring over the past 12 months, with a couple of recent transactions indicating slightly more aggressive debt to EBITDA multiples.

However, the devil is always in the detail. A large part of the negotiation on debt packages for LBOs concentrates on the definition of EBITDA. Add backs for run-rate cost savings and restructuring costs

and adjustments for permitted acquisitions and disposals can frequently manipulate an EBITDA calculation from a 'pure cash' formulation.

The mezzanine debt market still appears to be relatively thin. Of the transactions listed below, only the Healthscope and QSR transactions involved debt other than senior debt. However, the indications from competing bids, aborted transactions and talk from market participants is that there is increasing interest from mezzanine debt participants, particularly those offshore, in the Australian market. This is likely to be further enhanced by the development of a standard set of intercreditor terms described below.

Recent Australian LBOs									
Transaction Details			Transaction Terms			Capital Structure		Debt Terms	
Date	Company	Sponsor	EV	LTM EBITDA	EV / EBITDA	TD / EBITDA	SD / EBITDA	Margins	Upfronts
Aug-11	MYOB	Bain Capital	1,200	105	11.43x	5.00x	5.00x	425-450	-500
Jun-11	Healthcare	Archer	230	27	8.52x	4.00x ¹	4.00x	400-425	-500
Jun-11	QSR	Archer	450	50	9.00x	5.00x	3.75x	425-450	375-400 ²
May-11	Ausco	TDR	650	100	6.50x	3.75x	3.75x	425-450	500 ³
May-11	V8 Supercars	Archer	300 ⁴	30	10.00x	2.25x	2.25x	300	n/a
Jan-11	Tegel Foods	Affinity	466	58	8.06x	4.25x	4.25x	425-450	475-525
Jul-10	Healthscope	TPG / Carlyle	2,778	281	9.90x	5.00x	4.25x	400-425	425
Jul-10	ATF Group	CHAMP	250	38	6.53x	4.40x	4.40x	>400	n/a
Jun-10	Study Group	Providence	660	61	10.82x	3.75x	3.75x	450-475	450-475

All figures in AUD million

Notes: 1) Excludes capex facility 2) No underwrite 3) Includes fees associated with equity bridge 4) Archer acquired 60% stake

Source: The Carlyle Group/Loan Connector

Unlike overseas markets, Australia has never had a consistent set of intercreditor principles.

Market trends

We have seen the use of significant capital expenditure facilities incorporated into debt facilities for LBOs of which the Healthe Care acquisition is a good example. Target companies that have been constrained because of liquidity shortage from previous owners may see significant growth with a substantial capital expenditure injection. Banks appear to be willing to support this, provided appropriate conditions precedent are included to drawdowns under the capex facility.

Future acquisition facilities included within the LBO financing package have been less common. The cost of maintaining such committed facilities appears to outweigh the benefit of having a commitment on day one.

We will wait to see whether the most recent private equity transaction starts another trend. SCA Hygiene involved a Swedish headquartered company with global reach selling a 50 per cent interest in its Australasian operations to PEP. Selling a 50 per cent or minority interest can achieve the benefit of reducing debt or freeing up capital to be deployed by the parent where needed most. With European markets currently struggling, this could be a model adopted by other global operations in similar situations.

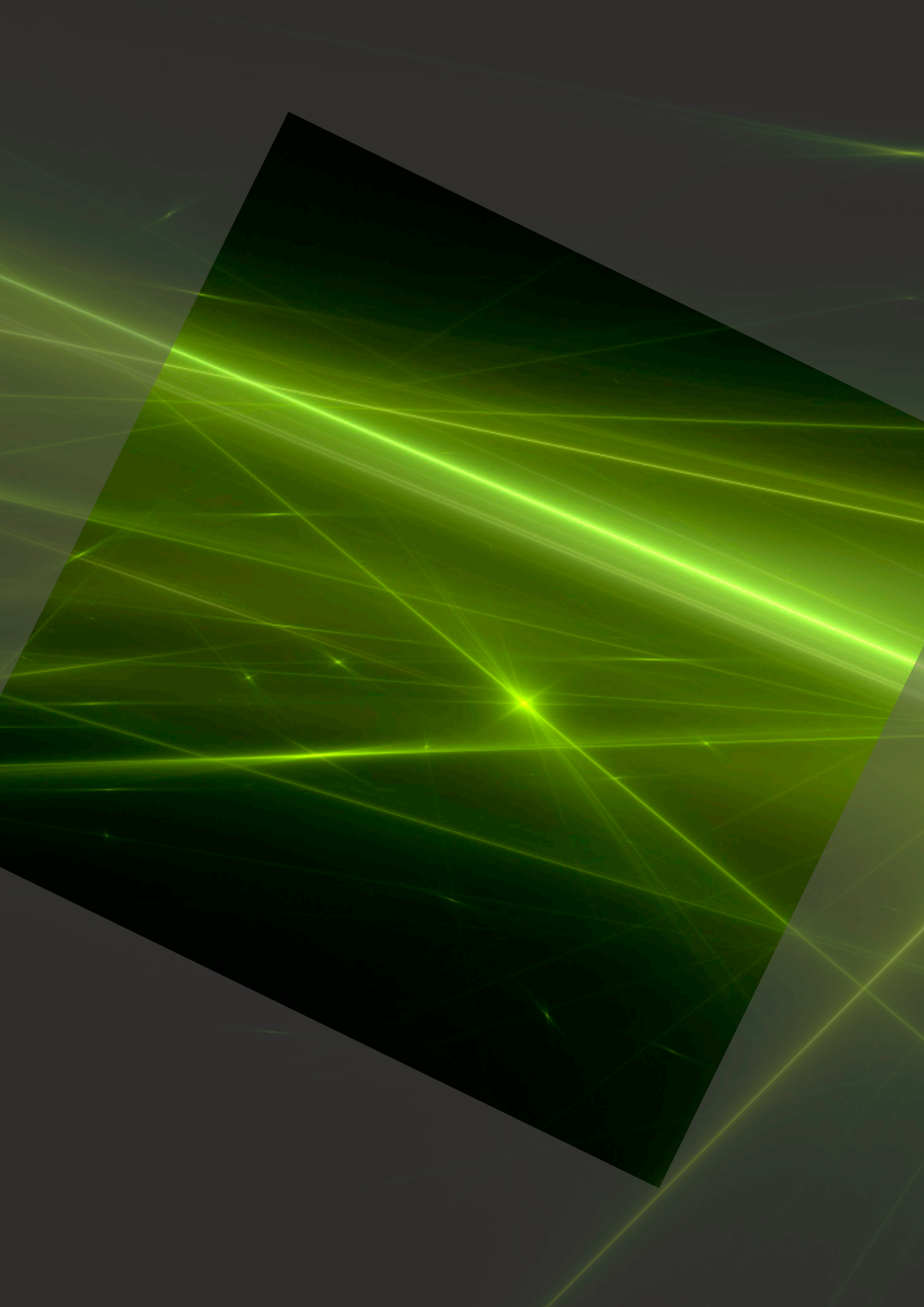
Documentation terms

The global financial crisis has had little impact on the attractiveness of equity cures, certain funds, deemed remedy of financial covenants, or replacement of financier clauses to private equity sponsors. However, it has focussed the attention of banks on those provisions that became contentious or were heavily

relied on during times of borrower stress. The assignments clause (dictating the circumstances in which a bank can sell down its participation or commitment) and the disenfranchisement clause (setting out the circumstances in which a borrower or sponsor can purchase debt participations and their rights if they do so) are likely to be heavily negotiated.

One recent development has been an initiative instigated by Westpac, and developed in conjunction with the other three Australian domestic banks, to produce a standard set of intercreditor principles. Unlike overseas markets, Australia has never had a consistent set of intercreditor principles. The idea behind the initiative is that a standard set of intercreditor principles will avoid inconsistency and therefore attract more mezzanine debt players into the market. However, it remains to be seen whether this will be achieved. There have been arguments that, by being developed by the dominant senior debt players in the market, the principles may lack credibility. However, this is countered by the fact that the four Australian domestic banks have actively solicited feedback from mezzanine debt participants and the fact that the intercreditor principles provide for greater enforcement rights in favour of mezzanine debt participants than exist in many current transactions. Ultimately, the principles will need to be tested by a significant transaction. It will be difficult to find consensus across various participants with different vested interests without the deadline of a transaction to be completed.

Tom Highnam is a partner in Allens' Banking and Finance team with significant acquisition finance experience. He recently advised Archer Capital on its acquisition of Healthe Care Australia Pty Limited and the financiers on Bright Food's acquisition of Manassen Foods and Providence Equity Partners' acquisition of Study Group.



The Australian private equity exit market

2011 has been a busy year for Australian private equity exits, despite difficult IPO market conditions. Domestic sponsors have been particularly active in exiting investments in preparation for entering the tough fundraising market. Partner Mark Malinas reports.

One of the dominant themes of 2011 has been the continued increase in Australian secondary transactions. This activity has included portfolio asset sales from one domestic sponsor to another, as well as from domestic sponsors to offshore sponsors. The headline secondary deal of 2011 was the sale of accounting software business MYOB by Archer Capital and co-owner HarbourVest Partners to US sponsor Bain Capital for over A\$1.2 billion.

In terms of IPO exits, Pacific Equity Partners portfolio company, Collins Foods, completed the largest private equity-backed IPO for two years, benefitting from the strong trading performance of ASX-listed comparable, Domino's Pizza. However, the poor ASX trading performance of Myer Group and, more recently, Collins Foods, is likely to generate continued scepticism from Australian institutional fund managers in assessing private equity-backed IPOs.

Chinese and Japanese interest in Australian private equity assets has also been strong in 2011, evidenced by the sale of Independent Liquor to Japan's Asahi Group, and Manassen Foods to China's Bright Food Group. We expect that Asian buyers will continue to be targeted as likely acquirers of quality Australian consumer product assets held by Australian private equity sponsors.

Top 10 Australian PE exits for 2011 to date *

	Investment	Exiting private equity firm	Acquirer	Deal value (AUD millions)
1.	Seven Media Group Pty Ltd	Kohlberg Kravis Roberts & Co	West Australian Newspapers	4,141
2.	Independent Liquor Group	Pacific Equity Partners	Asahi Holdings	1,253
3.	MYOB	Archer Capital; HarbourVest Partners; Squadron Capital; Industry Funds Management	Bain Capital	1,205
4.	Rebel Sport	Archer Capital	Super Retail Group	610
5.	Veda Advantage (50%)	North Cove Partners	Pacific Equity Partners	588
6.	Quick Service Restaurants	Quadrant Private Equity	Archer Capital	477
7.	Tegel Foods	Pacific Equity Partners	Affinity Equity Partners	463
8.	Manassen Foods Australia	CHAMP Private Equity	Bright Food Group	416
9.	Cellarmaster Wines	Archer Capital	Woolworths	343
10.	Mincom	Francisco Partners	ABB	Deal value not disclosed

* Completed deals. January 2011 – October 2011.

Source: Thomson Reuters

Locked box mechanisms have a number of advantages for private equity sellers.

The Australian exit market has also seen the continued development of legal structures designed to limit the liability of the exiting sponsor to the maximum extent possible and achieve maximum purchase price certainty, such as warranty and indemnity insurance and 'locked box' exit mechanisms. We look at some of these structures and explain the latest developments below.

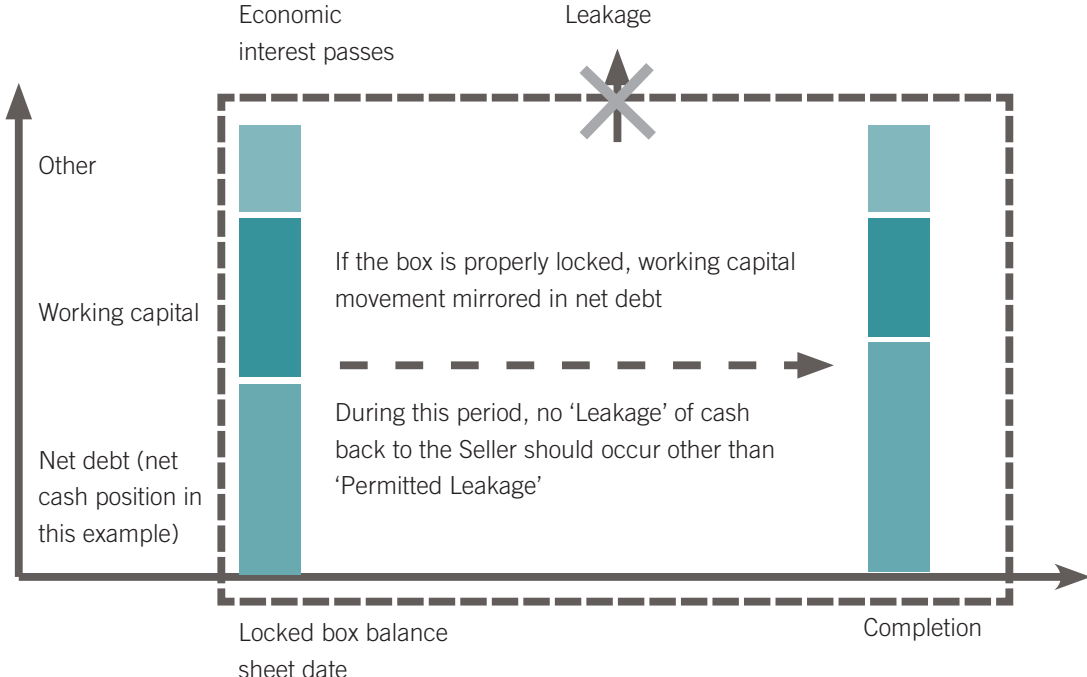
The 'locked box'

An increasingly common feature in recent Australian private equity exits is the 'locked box' mechanism. Under a locked box mechanism, the purchase price (which is based on the equity value, rather than the enterprise value, of the shares) is calculated on a defined historical balance sheet date. The result is that the equity purchase price payable at completion is fixed, with no further adjustment on or after completion required. The economic risk and reward of the business effectively passes to the buyer at the locked box date, and the seller agrees not to extract any value from the target business between the locked box date and completion (except where pre-agreed and therefore priced-in). As the consideration is not paid to the seller

until the completion date, the seller usually expects some form of compensation for the value that will accrue in the business between the locked box date and the completion date (this 'compensation' is usually expressed in the purchase agreement as an interest rate or finance charge on the equity price).

Locked box mechanisms have a number of advantages for private equity sellers. In particular, a locked box mechanism provides certainty over consideration. As the sale consideration is fixed at completion, a private equity seller can immediately distribute the entire sale proceeds to its limited partners. Under a completion accounts mechanism, a private equity seller would typically retain some of the sale proceeds in case the subsequent adjustment result is in favour of the buyer. Locked box mechanisms also avoid the often disruptive, expensive or disputed completion accounts mechanism.

If a private equity seller adopts a locked box mechanism as part of a sale process for an asset, it should be aware that many buyers (including both strategic and financial) may not be familiar with this type of mechanism.



The diagram above shows the relationship between working capital and debt in a 'proper' locked box transaction.

In order for buyers to be comfortable with the locked box approach, sellers will need to provide:

- a detailed and accurate balance sheet at the locked box date;
- detailed balance sheet and cash flow forecasts through to the expected completion date; and
- sale agreement warranties and/or indemnities that the locked box balance sheet is correct and accurate and that no unauthorised leakage will occur between the locked box date and completion.

The availability of W&I insurance greatly assists private equity sellers in the Australian market.

Generally speaking, a locked box mechanism carries greater risk for a buyer, as it will, in effect, become the economic owner of the business from the locked box date, with changes in the target's financial position being at the buyer's risk from that date. While control of the business will remain with the seller in the pre-completion period, the risk to the buyer should be assessed in the context of pre-completion obligations impacting business operations in the sale agreement. A further drawback for a buyer is that the seller has control over the preparation of the locked box balance sheet and an informational advantage. So, in the absence of a competitive auction or a highly sought-after asset, a buyer may insist on a traditional completion accounts mechanism.

W&I insurance

The use of warranty and indemnity insurance (**W&I insurance**) has become commonplace in Australian private equity trade and secondary exits in recent years. The commercial benefits of W&I insurance are now well-understood by Australian private equity and, increasingly, trade buyers. They include:

- facilitating a 'clean exit' and purchase price certainty;

- avoiding difficulties with, or an inability to, 'price' risk; and
- providing buyers with comfort that a warranty claim will be met irrespective of a seller's fortunes (among others).

W&I insurance is available to both buyers and sellers in the Australian market. In our experience, buy-side policies are preferred in the context of private equity exits, as they allow the buyer to claim directly from the insurer without direct involvement of the seller. This better meets the objective of a 'clean exit' compared with sell-side policies, where a private equity seller would be required to cooperate with insurers in respect of the management of a claim.

The past 24 months has also seen a significant reduction in the premiums payable under W&I insurance policies. The market rate is now 1 to 2 per cent of the dollar amount of the seller's liability cap, down from the 3 to 5 per cent premiums seen in previous years. A number of factors will influence the premium payable in a particular circumstance, including the size and structure of liability limitations, caps and thresholds, the claim period, the target industry and the existence of potential claims that are difficult or onerous to quantify (eg tax or environmental claims).

In our experience, acting for both transaction parties and insurers, the process of obtaining W&I insurance can be undertaken in as little as three to four days where final diligence reports and a settled sale agreement are available. Insurers will conduct their own due diligence process, which typically involves a review of draft sale documentation and available due diligence material, together with followup Q&A. The focus of the insurer's review is to determine whether issues identified have been adequately addressed through provisions in the sale documentation or disclosure by the seller. Where found to be inadequate, specific warranties may be carved out from the policy or the premium increased.

The availability of W&I insurance greatly assists private equity sellers in the Australian market in resisting escrow or other deferred consideration arrangements and enabling the sale of portfolio companies on an effectively ‘non-recourse’ basis (subject to standard policy exclusions, such as fraud). This represents a contrast to the situation in the US, where private equity is less familiar with W&I insurance and premiums can be comparatively prohibitive.

We note that adopting a locked box mechanism and obtaining W&I insurance will, together, provide a seller with the cleanest exit and greatest purchase price certainty possible.

Intervention of the Australian Tax Office (*ATO*)

Another issue of which buyers of Australian private equity assets are conscious (particularly where non-resident sellers are involved) is the risk of ATO intervention pre- or post-closing. The concern from a buyer’s perspective is the potential risk to which they are exposed should the ATO seek a withholding or freezing order on proceeds payable to non-resident sellers. We have seen the ATO intervene on this basis in instances where it argues that the sale proceeds paid to non-resident investors are not capital gains (capital gains are tax-free in the hands of non-resident investors) but instead represent income derived from the investor’s regular investment activities (which are taxable where the income is derived in Australia).

One of the main reasons for this concern in the Australian private equity market stems from the ATO’s highly publicised bid to freeze the Myer float proceeds of certain non-resident investors back in 2009. This issue is discussed separately in Thomas McAuliffe’s article on tax structuring alternatives to deal with the ATO’s position on the treatment of proceeds to be received by foreign investors from the sale of Australian private equity portfolio assets.

To deal with this risk, buyers often look to include provisions in the sale agreement to the effect that the buyer is entitled to deduct or withhold from the purchase price amounts that a tax authority require to be deducted or withheld and, notwithstanding this, the sellers remain obligated to complete the deal on this basis. This ensures that ATO intervention does not prevent or postpone closing of the deal.

Dealing with buyer financing risk

In the wake of continued global credit market volatility, a number of trends have emerged on recent private equity exits that reflect an increased focus on minimising transaction conditionality and risks associated with buyer financing. The trends below are not yet common in the Australian market but are likely to be a feature of future exits if the Eurozone banking issues continue to impact on the Australian leveraged finance market.

- In secondary transactions, it has become increasingly common for a seller to accept a ‘reverse’ break fee from the buyer as the seller’s exclusive remedy in the event that completion does not occur because adequate debt financing is unavailable. The reverse break fee is frequently higher than any break fee a seller would be required to pay.

- Private equity sellers are seeking direct or third party beneficiary enforcement rights under equity and debt financing documents. These are commonly provided in equity financing documentation.
- Lenders have typically been successful in resisting such rights in loan documentation, but it is common for buyers to separately provide private equity sellers with the right to require the buyer to enforce its rights under a loan facility.
- Private equity sellers are seeking direct or third party beneficiary enforcement rights under equity and debt financing documents.

Mark Malinas is a partner in Allens' M&A and Capital Markets team. He recently advised Catalyst Investment Managers on its acquisition of Actrol Parts and a number of bolt-on acquisitions during 2011.



Australia's superannuation revolution: what it means for private equity fundraising in Australia

Australia's superannuation industry is in the midst of a quiet revolution. Senior Associate Geoff Sanders and Partner Susan Burns examine whether that revolution represents an opportunity or a threat (or perhaps both) to foreign and domestic private equity sponsors in their efforts to raise capital in Australia.

At the core of the changes is the introduction of a simplified, low-cost superannuation product to be known as 'MySuper'

Australia's compulsory superannuation system, already the home of more than A\$1.4 trillion of the retirement savings of ordinary Australians, is about to see some of the most fundamental changes to its regulatory framework since its introduction in 1992.

At the core of the changes is the introduction of a simplified, low-cost superannuation product to be known as 'MySuper' which is set to become the default choice of fund for the eight out of 10 Australians that do not currently make an active choice as to their superannuation fund. Importantly, trustees of MySuper products will be required to focus on reducing fees and costs of their offerings – this focus on cost, along with a range of associated regulatory developments, will create both a number of opportunities and challenges for private equity sponsors seeking to raise capital from Australian superannuation funds. We examine some of these below.

MySuper – a need for private equity sponsors to better demonstrate value for money

MySuper is intended to introduce a simple, cost-effective default superannuation product for the majority of Australians from July 2013 (with a transitional period ending in July 2017 for the migration of existing account balances to MySuper products).

A key element of all MySuper products will be the need for trustees to develop a single, diversified investment strategy, which is able to be offered to fund members at a single pricing point. Importantly, the core features of MySuper products from an investment perspective will include:

- 1 A specific obligation on trustees to have regard to the expected costs in implementing investment strategies, aimed at optimising the best financial interests of members as reflected in net investment returns over the longer term.
- 2 The introduction of 'comply-or-explain' guidelines on the structure of any performance fee payable to third party managers in respect of the assets of a MySuper fund. The guidelines suggest that:
 - performance fees should be measured on an after-tax basis;
 - that there be an appropriate benchmark and hurdle reflecting the risk of the investments made;
 - there is an appropriate testing period for the payment of fees; and
 - there be provision for the adjustment of fees to recoup prior or subsequent underperformance).
- 3 An obligation on trustees to 'clearly articulate' target rates of return over a rolling 10-year period, as well as the level of risk that the trustee of the product has determined is appropriate for members.

It will be important for both domestic and foreign private equity sponsors wanting to fundraise from MySuper investors to recognise the pressures that the new MySuper fee reforms place on trustees.

- 4 The introduction of an ability to offer a ‘lifecycle’ investment strategy; that is an investment strategy that enables trustees to automatically move members into different investment mixes based on their age.

The focus on fees and costs of MySuper products is expressly designed to reduce the total fees and costs being paid by fund members on their retirement savings and is expected to sharpen trustee’s focus on fees paid to external asset managers, particularly those parts of the asset management industry that are seen to be ‘high cost’, such as private equity.

This focus initially led some in the private equity industry in Australia to fear for the long-term viability of the asset. Importantly, however, the new MySuper rules stop well short of seeking to impose a prohibition on the payment of increased fee rates for appropriate asset classes or a ban on the payment of performance fees – rather, the government describes the changes as being designed simply to ensure that trustees consider the ‘value for money’ received from each asset class (ie by focusing on after-fee and after-tax returns, rather than purely on cost).

Indeed, the ‘comply-or-explain’ performance fee guidelines expected to be introduced in conjunction with MySuper are already largely consistent with the carried interest structures utilised by most of the private equity industry. Accordingly, sponsors should be able to relatively easily demonstrate that the structure of most carried interest fee scheme (as well as associated investor protection mechanisms such as whole-of-fund carry structures and clawback mechanisms) already fit well into the characteristics sought to be met under the new statutory tests.

As a result, while the introduction of the low-cost MySuper products will no doubt bring renewed focus from trustees on headline fee rates (and may lead to some more risk-averse trustees shying away from more expensive asset classes altogether), the reforms should not be seen as the

death-knell of private equity in Australia. Instead, the reforms should be seen as a challenge to private equity sponsors to more effectively demonstrate the after-fee (including performance fees), after-tax returns and other benefits of investing in the asset class – those sponsors that are most successful at doing so may actually benefit from the introduction of MySuper, as there is no longer any doubt that private equity allocations have a place in the new MySuper world and sponsors that can demonstrate value for money will get the lion’s share of those allocations.

Nonetheless, it will be important for both domestic and foreign private equity sponsors wanting to fundraise from MySuper investors to recognise the pressures that the new MySuper fee reforms place on trustees. It will therefore be necessary for sponsors to work together with investors to refine existing fee structures to assist trustees in meeting their statutory obligations – again, this represents an opportunity for the more flexible, forward-thinking sponsors to be leaders in bringing products to market in Australia that best meet some of those new challenges for both sponsors and MySuper funds.

Opportunities created by industry consolidation

The flip-side of the introduction of the MySuper products is a clear, government-endorsed push towards an accelerated rate of consolidation in the superannuation industry in Australia.

In particular, the Australian Government has made it clear that it considers that the current superannuation industry is too fragmented and has tailored its policies towards encouraging consolidation to take place.

For example, as part of the MySuper package of reforms, the trustees of MySuper products are to be subject to an annual obligation to assess whether their MySuper product has sufficient scale to continue as a stand-alone product. In addition, temporary tax breaks currently offered to trustees

This focus on increasing liquidity across the entire portfolio of a fund does not necessarily sit easily with the current model of private equity.

of merging superannuation funds have been extended a number of times and discussions are progressing between the industry and the Government in order to make those tax breaks permanent.

This push towards industry consolidation has the Government's advisers predicting that, by 2025, the industry will have as few as 27 Australian Prudential Regulatory Authority (**APRA**) regulated funds (down from more than 400 today), each having an average of A\$75 billion in funds under management. This process of consolidation will fuel the growth in average funds under management of Australian funds, something that may be further boosted by the proposed increase in the mandatory rate of minimum superannuation contributions for working Australians from the current 9 per cent of wages to 12 per cent.

While all of this consolidation will have the obvious effect of reducing the overall number of potential customers for private equity firms in Australia, we believe that sponsors should view this process as an opportunity rather than a threat as larger, more professional, funds may be more likely to increase allocations to 'alternative' asset classes such as private equity. Those private equity sponsors who are able to foster long-term relationships with influential super funds should be able to build on those relationships as those funds move through the cycle of mergers and consolidations to come.

A need for liquidity

Finally, it is expected that the introduction of the MySuper reform package (along with the increasing mobility of members across funds and APRA's response to the liquidity issues arising out of the global financial crisis) will also lead to a renewed focus from Australia's superannuation regulator APRA on the liquidity of superannuation funds' investment portfolios.

This focus on increasing liquidity across

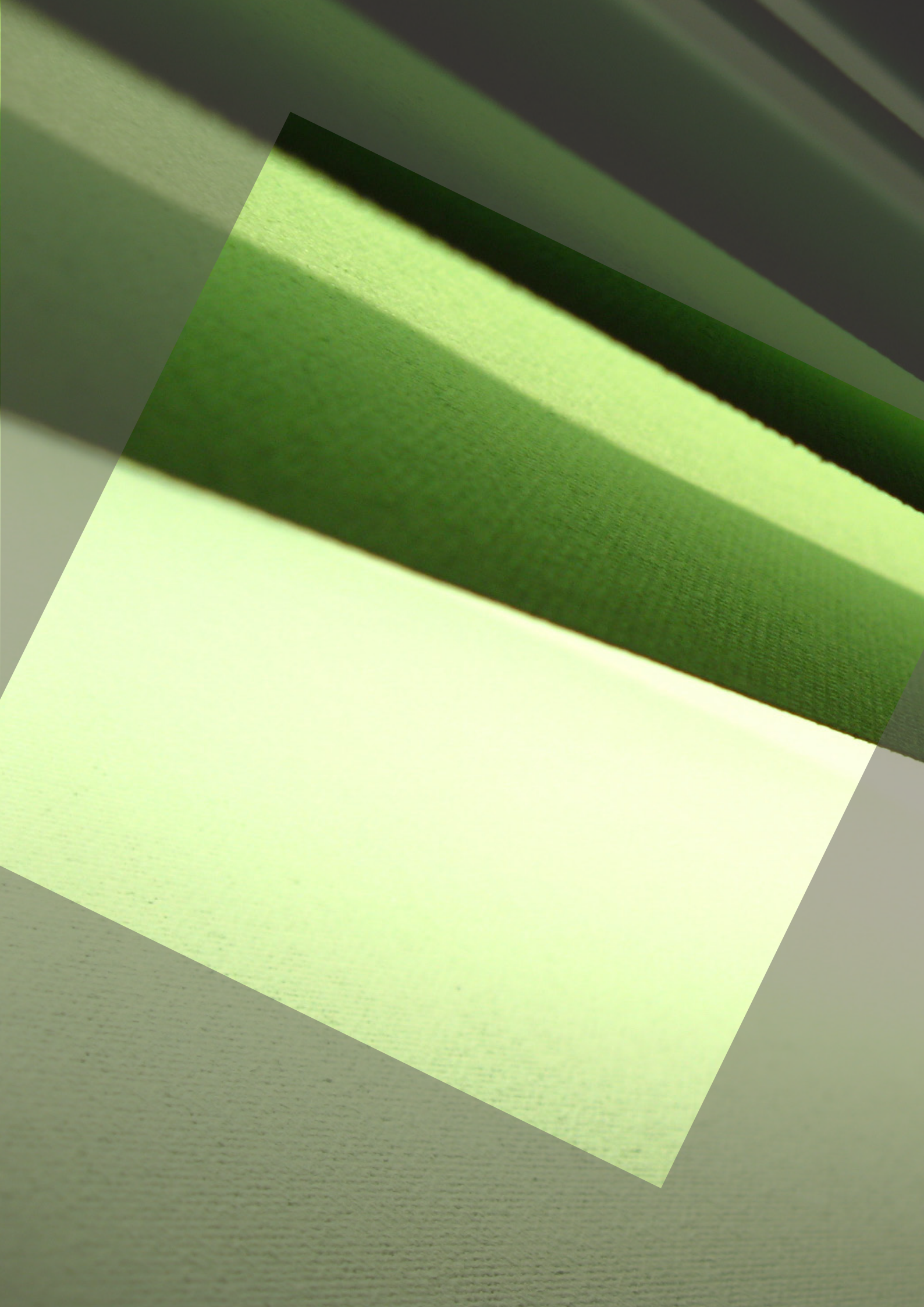
the entire portfolio of a fund does not necessarily sit easily with the current model of private equity. While some (perhaps many) trustees may continue to be comfortable with a small portion of their overall portfolio being tied up in longer-term, illiquid investments such as private equity and unlisted infrastructure, other trustees may need to be convinced that liquidity is available in those investment classes if it is needed.

As a result, private equity sponsors may need to become more active in helping develop more efficient secondary markets for private equity interests and, perhaps, be more open to fund structures that provide a limited form of liquidity in some circumstances.

In summary, while the MySuper and related reform package (and its increased focus on lowering investment costs for MySuper funds) clearly represents a challenge to private equity sponsors seeking to raise capital from Australian superannuation investors, we believe that those firms who are able to proactively work with trustees to demonstrate value for money, to develop tailored fee structures and to be creative on creating liquidity will be well-placed to benefit from the increasing size and sophistication that the reforms are expected to bring.

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Susan Burns heads our Funds Management practice and regularly advises private equity sponsors on fund structures, including Managed Investment Trusts.



Restructuring distressed debt

The impact of the global financial crisis, in particular in the highly leveraged listed infrastructure and property sector, created opportunities for private equity and other investors. During 2011, private equity acquirers played a role in the debt-for-equity transaction that saw the resolution to the Alinta Energy Group restructure. As we sit here today, the current trading environment and refinancing options look like opening up opportunities for similar transactions for private equity buyers and lenders to private equity investments. Partner Vijay Cugati provides an overview on the lessons learnt from the Alinta transaction that may provide a guide for debt-to-equity transactions in the future.

In the next 18 months, more than \$100 billion of debt will need to be refinanced in a variety of industries, including real estate, media, utilities and infrastructure.

It is unlikely that any reader would disagree that we've been witnessing real-time financial instability on a global scale. As minuted at the Monetary Policy Meeting of Australia's Reserve Bank Board on 4 October 2011, 'the extreme volatility observed in financial markets in August continued through September, with large swings occurring in share prices, exchange rates and bond yields'.

Australia has not been immune to global events. Although investment in the resources and mining sector continued to be very strong, the Reserve Bank Board observed that conditions remained weak in the manufacturing, construction, wholesale and retail sectors. It also noted that, as had been the case elsewhere around the world, business confidence had fallen noticeably and growth in business credit remained weak.

Against this difficult economic backdrop, the Australian financial press has repeatedly commented on the upcoming refinancing obligations of Australian companies. Although refinancings are a regular part of the annual financial calendar, it is the combination of routine refinancings, along with the refinancing of a number of significant infrastructure developments coupled with the large number of leveraged transactions completed in 2006 and 2007, that has created, as some have called it, a 'debt wall'.

It is expected that, in the next 18 months, more than \$100 billion of debt will need to be refinanced in a variety of industries in Australia, including real estate, media, utilities and infrastructure.

If the debt markets deteriorate and alternative funding solutions such as mezzanine debt and private capital are not available, then it is likely that restructuring options will need to be considered. The Australian market has already seen a number of private equity sponsor portfolio companies enter receivership this year, including Pacific Equity Partners' book retailer REDgroup and Affinity Equity Partners' retailer Colorado Group. There have also been a number of situations where the sponsors have seen the debt traded to the control of increasingly activist hedge funds and distressed debt investors. Recent examples include Unitas Capital and Ontario Teachers Pension Plan's New Zealand Yellow Pages, Pacific Equity Partners' vacuum cleaner business Godfreys, Crescent Capital Partners and Catalyst Investment Managers' New Zealand Metroglass and CVC Asia Pacific's radiology business I-MED. In addition, there has been much market chatter pointing to active discussions with lenders about capital structure and debt load, the largest being CVC Asia Pacific's Nine Entertainment Group.

In the context of restructuring options, 2011 has also seen the re-emergence of schemes of arrangement as an effective tool for restructures. The two largest restructures of the year, both in complexity and scale, were Alinta Energy and that proposed for Centro Properties. Both restructures occurred outside a formal insolvency process. In addition, both involved a number of hedge funds and distressed debt investors and, in the Alinta Energy transaction, led to a change of control to the syndicate lenders (including TPG, Oaktree and Anchorage).

Allens acted on behalf of the syndicate lenders through our role for the Commonwealth Bank (**CBA**) as agent and as security trustee in the Alinta matter, which concerned the restructure of a \$2.8 billion debt facility through four creditors' schemes of arrangement, involving a debt-for-equity swap in respect of the secured debt, and a transfer of ownership of the operating companies in the Alinta Energy group to an entity controlled by the lenders. On the Centro matter, Allens acted for the steering committee of the consortium of Australian lenders (JPMorgan, ANZ, CBA, NAB, BNP Paribas, Sumitomo, West LB and RBS) on the work-out and restructuring of the Centro Properties group, whose debt burden exceeded the entire value of its assets by more than \$1.6 billion at 31 December 2010.

Given our experience in the Alinta Energy and Centro matters, we have explored some of the reasons why debt for equity swap schemes can be attractive restructuring vehicles, some of the lessons learned and some of the tax considerations, both from a creditor and debtor entity perspective. See the tables on following pages for more information.

If the debt markets deteriorate and alternative funding solutions such as mezzanine debt and private capital are not available, then it is likely that restructuring options will need to be considered for the 'debt wall' as an alternative to refinancing. With the increasing trend in Australia of trading in tranches of the secured debt of distressed companies and the consequent growth in numbers of secured lenders, the use of a scheme of arrangement has a number of advantages, notably the ability of the majority to bind dissenting creditors. Although such transactions can be complex and relatively costly to implement, they may result in a better return for creditors and, possibly shareholders, having regard to the value remaining in the business and the terms of a proposal, than may be available under a formal insolvency process.

Advantages of a creditors' scheme of arrangement

As a means of restructuring the debt owed, a creditors' scheme of arrangement has a number of advantages that include the following:

Equity ownership

The ownership of equity received by members of the lender syndicate as a result of the debt for equity swap may provide partial recovery against losses incurred by those members who receive such equity, on the face value of the original loans.

Transaction certainty

A scheme of arrangement achieves transaction certainty for the debtor entity and for all scheme creditors as a result of the binding nature of a court-approved process.

Avoiding formal insolvency processes

The transaction structure avoids the costs, delays and uncertainty that could result from formal insolvency processes such as voluntary administration, liquidation and/or receivership. In particular, it avoids the potential negative impacts on contracts and regulatory licences that can arise in a formal process.

Reduction of debt

The solvency of all of the debtor group is improved by the reduction in level of debt.

Retain security

The security over the debtor group is retained.

Distressed debt restructuring: Lessons learned

Given the complexity of the Alinta Energy and Centro matters, there were many issues that needed to be considered and resolved. Accordingly, we have focused on some of the lessons learned relating to the financing aspects that we think would be of interest to those investing in distressed debt and those whose portfolio companies are subject to active debt trading.

Debt transfers and the giving of instructions

Under a syndicated financing in a distressed debt environment, there is likely to be both a large amount of debt trading and numerous issues on which the agent and security trustee will need to seek the instructions of the majority (or all) of the lenders. A question arises as to whether an instruction given by a lender before a debt trade will be binding on the transferee of that debt. If the agent/security trustee has not yet acted on the relevant instruction, the purchaser of the debt might want to know if it will be bound by the instruction and/or whether it has the right to revoke such instruction. A prudent debt purchaser should ask the transferor what instructions the transferor has recently given to the agent and security trustee.

Inability to split vote

For various reasons, purchasers of distressed debt sometimes prefer to take a sub-participation from a fronting bank or use a nominee/custodian as the registered holder of a loan instead of holding the loan in their own name. To the extent the nominee is acting for more than one participant, it is likely that the nominee will only be able to instruct the agent and security trustee to the extent it has received identical instructions from all principals. If the fronting bank has one sub-participant instructing it to vote in favour of a certain course of action, and one participant instructing it to vote against that course of action, the fronting bank will be hamstrung and will be unable to vote (which, more often than not, is essentially the same as voting 'no'). To solve this problem, Allens is currently considering inserting wording in syndicated facility documentation that would allow banks to 'split' their votes. However it is unlikely such wording will be in the facility documentation for existing borrowers in the distressed debt market.

Ability to abstain

Often a syndicate will include a number of lenders who are either unwilling or unable to give instructions to the agent for given matters. ‘Snooze and lose’ clauses (provisions that allow the agent to discount non-responsive lenders after a given period of time) are becoming fairly standard in finance documentation. However, such clauses are not a complete solution, as the agent might be unwilling to rely on the ‘snooze and lose’ clause for more significant votes, and such provisions also generally need to allow for a ‘reasonable’ amount of time to pass before the non-responsive lender can be discounted. It is preferable to include an ‘abstaining’ clause in addition to the ‘snooze and lose’ clause. The abstaining clause allows a lender to notify the agent that it will not be voting on a certain issue and its exposure should be taken as nil for the purposes of the vote. From an agency management perspective, such a clause allows votes to be taken more quickly. This clause can be added to existing documentation by way of amendment – if there are numerous members in a syndicate, it is certainly a convenient clause to have during the restructuring process.

Majority lenders can bind all lenders

One key problem for a large syndicate in a distressed debt environment is the likelihood that there will be one or more lenders that are not necessarily interested in restructuring the debt, but are interested in ‘greenmailing’ the syndicate. One solution is to include a provision in the finance documents, which essentially sets out that an amendment, waiver or release, which would ordinarily require unanimous lender consent, will only require majority lender consent if the majority lender group is ‘of the good faith view that it would be beneficial to all lenders’. There will (in most cases) need to be a unanimous lender consent to add such a provision to the finance documentation in the first instance. Accordingly, it makes sense to add such a clause as early as possible in the restructuring process. From an individual lender’s perspective, there are inherent risks with such a provision, and it is possible that some lenders with smaller exposures will object to it on principle.

Sponsor disenfranchisement

Most leveraged finance documents include a ‘sponsor disenfranchisement’ clause (a provision which stipulates that if a member of the borrower group (or a related party) purchases debt, its exposure will be taken to be nil for voting purposes); however, this has yet to truly become market standard in all finance documents in Australia. Without such a provision, if the borrower group purchases even a small amount of debt, it will be in a position to disrupt any ‘unanimous’ voting decisions. This could obviously be problematic for restructuring the debt.

Release of security

For a successful restructure, it is important to have an effective mechanism for the release of security held by the lenders. The absence of an effective mechanism will likely complicate and delay the restructure, and may afford an opportunity for potential ‘greenmailers’. A variety of different mechanisms for the release of security in financing documents currently exist, with little standardisation. While the lenders’ requirements may vary from transaction to transaction, clauses that provide for security to be released, for example, with majority approval or at the agent’s general discretion following enforcement of the security will assist in any subsequent restructure.

Suspension of debt trading

The agent of a distressed debt syndicate might need to suspend trading of debt for a certain period of time for administrative reasons. The agent's right to do this may be expressly set out in (or implied by) the terms of the finance documentation. If there is going to be a creditors' scheme meeting to approve a scheme of arrangement, then it is likely the scheme administrator will require a suspension of debt trading so that the relevant notices can be served on the creditors (ie the lenders) within the statutory required time periods. Lenders to a distressed borrower should seek confirmation from the agent with respect to its plans to suspend trading and should be provided with sufficient warning before any such suspension.

Tax considerations

The tax considerations in both the Alinta Energy and Centro matters were complex. The consequences of a debt for equity swap will depend critically on the exact facts and circumstances of the arrangement, and the precise way in which it is structured and documented. As such, the comments below are of a general nature and are aimed at illustrating the types of issues that may require consideration.

For the creditor, the tax matters to be considered include the following.

Discharge of the debt interests

Depending upon the circumstances of the arrangement and subject to satisfying specific requirements, a creditor may be entitled to a deduction or a capital loss, or realise an assessable gain, upon the disposal of their debt interests, depending upon the value of the equity interests received and the debt discharged. Where a gain is realised, non-resident creditors may need to consider whether the gain has an Australian source, and, if so, whether treaty relief would be available to exempt such gain from Australian tax.

Acquisition of equity interests

Equity interests issued to creditors should have a cost base equal to the value of the debt interests exchanged.

Disposal of equity interests

Any gain made upon the ultimate disposal by a creditor of their equity interests may be subject to tax in Australia. If the gain has an Australian source, depending upon their particular circumstances, a non-resident creditor may be able to rely upon a treaty to exempt any gain made from Australian tax. While the Australian tax consequences will ultimately depend upon an individual creditor's circumstances (eg if they are a resident of a treaty country, whether they hold on capital or revenue account and other factors), non-resident creditors should note that, as a general rule, the practical effect of the Australian tax provisions is that gains made by a non-resident on the disposal of a 'land rich' entity (eg which can broadly be defined as an entity whose assets, in the majority, comprise of real property and mining, quarrying or prospecting rights) are less likely to be disregarded or exempt from Australian tax than gains made where the entity disposed of is not 'land rich'.

For the debtor entity, the tax matters to be considered include the following.

Limited recourse debt provisions

Where a debtor has obtained capital allowance deductions from expenditure that has been funded by debt, an 'additional depreciation clawback' may be required to be included in the debtor's assessable income in certain circumstances if that debt arrangement is terminated.

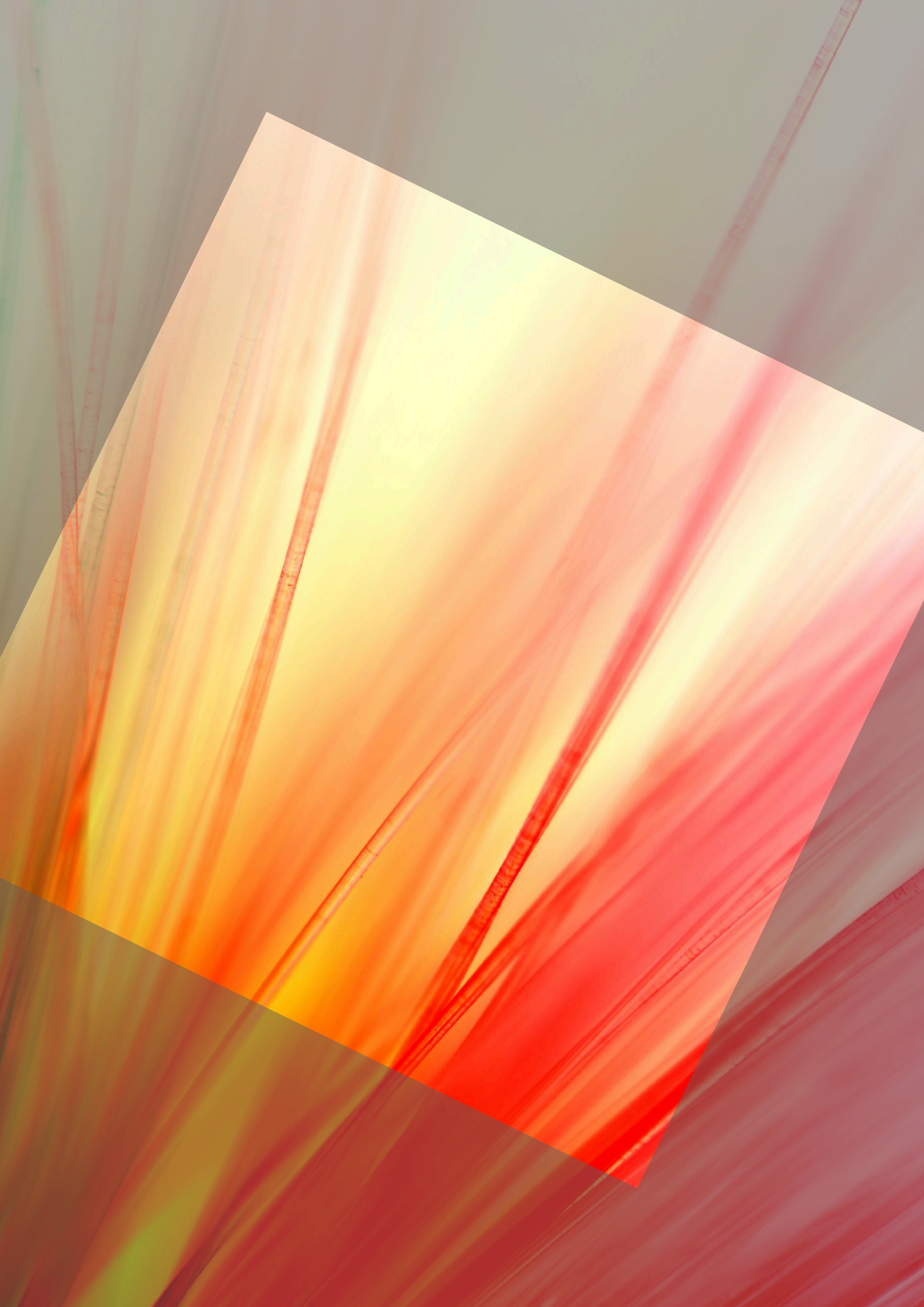
Commercial debt forgiveness provisions

Since entities involved in these types of restructures have typically generated significant tax losses, the potential impact of the commercial debt forgiveness provisions needs to be carefully considered. While the commercial debt forgiveness provisions do not result in an amount being included in the assessable income of the debtor, they do operate to reduce the debtor's tax attributes (in the following order: tax losses, capital losses, future income tax deductions and the cost base in CGT assets) if there is a 'net forgiven amount' as a result of the debt forgiveness. This can depend upon the way in which the commercial debt forgiveness is undertaken, the type of debt (eg special rules apply to non-recourse debt), and the circumstances giving rise to the forgiveness (eg the market value of the debt and the extent that the debtor has paid or given consideration for the release of the debt). The significance of this needs to be considered in light of the fact that the tax losses (if any) of the debtor may not be able to be utilised as a result of the restructure in any event (refer below).

Change in ownership – impact on carried forward losses

If there is a change in more than 50 per cent of the debtor's shareholders as a result of the debt for equity swap, a debtor who has carried forward tax losses on the basis of the continuity of ownership test may no longer be able to satisfy that test. If this is the case, the debtor would only be able to utilise its tax losses if it satisfies the alternative 'same business test' for the relevant testing period. If the same business test needs to be relied upon, this can impose practical constraints on what restructuring can be undertaken without endangering the tax losses. Creditors should also note that, if the debtor is a trust, only listed widely held trusts can rely upon the same business test to utilise their tax losses after a change in ownership.

Vijay Cugati is an M&A and Capital Markets partner and most recently advised on the deleveraging of the Alinta Energy Group, including the debt for equity swap involving TPG Opportunities Partners, Oaktree Capital & Anchorage Advisers.



Tax consequences for foreign investors investing in Australian assets

Understanding the Australian tax consequences of a potential investment in an Australian asset can be a complex process for foreign providers of private equity. Senior Associate Thomas McAuliffe examines some of the collective investment vehicles available to foreign investors and the role that tax treaties play in determining whether foreign investors are subject to Australian tax.

For foreign providers of private equity, arriving at an understanding of the Australian tax consequences of a potential investment in an Australian asset can be a complex process.

The publicity surrounding the Australian Taxation Office's (*ATO*) dispute with Texas Pacific Group in relation to the tax properly payable on the gain realised from the initial public offering of the Myer retail chain at the end of 2009 highlighted a maze of uncertainty around the Australian tax treatment of gains realised by foreign private equity investors. Those uncertainties have yet to be entirely resolved. However, some pathways to tax certainty have emerged, although they involve navigating complex rules and structures that are peculiar to Australia.

Australia does not have a specific tax regime for investments by 'private equity' as such. Instead, periodic investment returns and exit gains earned by foreign investors from an investment in Australian assets are subject to Australian tax according to a variety of statutory and common law rules, as affected by the operation of any applicable tax treaties.

The tax analysis for Australian providers of private equity is relatively straightforward and, in any case, those investors can reasonably be expected to be familiar with the Australian tax regime.

On the other hand, for foreign providers of private equity, arriving at an understanding of the Australian tax consequences of a potential investment in an Australian asset can be a complex process requiring significant assistance from Australian tax advisers.

Limited partnerships

The familiarity that foreign investors may have with limited partnerships as collective investment vehicles that allow tax flow-through of both profits and losses is of little assistance in the Australian context, where limited partnerships are generally treated as companies that are subject to tax on their profits at the corporate tax rate (currently 30 per cent). Although there is an exception to this treatment for a limited partnership that qualifies as a venture capital limited partnership (*VCLP*) (and variations thereof), the utilisation of these vehicles is rare because of narrow and complex eligibility criteria that must be met. In the meantime, the Australian Board of Taxation is currently examining the effectiveness of the special tax treatment accorded under the VCLP regime in a way that recognises its policy objectives, and is due to report to the Australian Government by December 2011.

Managed investment trusts

Another collective investment vehicle that has recently evolved in the Australian tax landscape is the 'managed investment trust' (*MIT*), a form of unit trust. Unit trusts do not allow for the tax flow-through of losses to investors and, as noted in the 2009 Report of the Australian Financial Centre Forum, entitled *Australia as a Financial Centre*, many potential foreign investors in Australian funds, particularly in the Asian region, do not come from common law jurisdictions and typically are not familiar or comfortable with trust structures (although some commentators have noted that the adoption of trust structures in that region is increasing).

It is encouraging that some avenues for achieving certainty in relation to the Australian tax consequences for foreign investors have emerged.

The MIT regime does provide certainty in respect of the Australian tax payable on distributions of income and gains realised by the MIT to foreign investors, including a concessional withholding tax rate of 7.5 per cent on certain such distributions, provided that various eligibility requirements are met by both the trust and the foreign investors on an ongoing basis. However, trusts that carry on, or have the ability to control (including, according to the ATO, the ability to exercise veto rights in respect of) the affairs or operations of, a ‘trading business’ (broadly, anything other than passive investments in land, debt securities, equity securities or derivatives) do not qualify and this is therefore an aspect of the investment that requires careful attention. Nor is the concessional tax treatment afforded to distributions to foreign investors on carried interests.

Tax treaties

Tax treaties also have an important role to play in determining the extent to which foreign investors are subject to Australian tax. The complication here is that foreign private equity funds are likely to be established in a jurisdiction with which Australia does not have a comprehensive tax treaty. In a welcome development, the ATO has announced a willingness, in certain circumstances, to look through collective investment vehicles that are partnerships to the home jurisdictions of the ultimate investors for the purposes of allowing those investors to rely on the tax treaty between their home jurisdiction and Australia. Such an approach will necessarily involve a degree of cooperation and disclosure from the collective investment vehicle and the ultimate investors in establishing, to the ATO’s satisfaction, that treaty relief from Australian tax applies to them. In addition, treaty relief is typically not available where the investee holds substantial land or mining rights in Australia.

If no tax treaty applies, the location of the source of any exit gain made by foreign investors needs to be considered. Notwithstanding some recent limited guidance from the ATO, certainty on this question remains elusive.

Conclusion

In the absence of certainty as to whether a tax treaty will apply to limit Australia’s taxing rights over income and gains realised by foreign investors from investments in Australian assets, or whether any exit gain will be regarded as having an Australian source, there has been a trend towards resorting to the certainty the MIT regime provides. Where not all of the underlying investments are eligible to be held by a MIT, it may be the case that those investments are eligible to be held by a VCLP, in which case foreign investors may be offered a ‘stapled’ investment (ie units in the MIT and limited partnership interests in the VCLP, with those units and interests only being able to be dealt with together).

Through the utilisation of such hybrid structures where circumstances allow, a degree of certainty as to the Australian tax outcome can be achieved. The price of that certainty is the acceptance of a certain level of Australian tax, in the form of MIT withholding. It also involves a level of complexity that potential foreign investors are likely to find perplexing. Should their investment committees be willing to persevere, their Australian tax advisers, or those of the Australian fund seeking their investment commitment, will be faced with the challenging task of explaining two sets of extremely complex rules to them.

Although the Australian Board of Taxation is currently reviewing the taxation of collective investment vehicles, a discussion paper the Board released in December 2010 states that the review is directed at vehicles that undertake primarily passive investment activities which, it notes, may not typically be the case for private equity funds. This review does, however, hold out some hope for further reform and simplification of the Australian taxation of collective investment vehicles.

It is encouraging that some avenues for achieving certainty in relation to the Australian tax consequences for foreign investors from investments in Australian assets have emerged since the end of 2009. However, the degree of difficulty remains high.

Thomas McAuliffe is a Senior Associate in Allens’ Tax group and advises on all aspects of corporate income tax and capital gains tax. He advises domestic and global sponsors in relation to mergers and acquisitions, fund structuring and tax disputes.

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Recent Allens private equity deals

2010 – 2011 transactions	Our client
Bain Capital's acquisition of MYOB Limited from an Archer Capital-led consortium, the largest private equity transaction of 2011 in the Australian market.	<i>Archer Capital consortium</i>
Archer Capital's acquisition of Health Care Australia Pty Limited, the third-largest for-profit private hospital operator in Australia, from a CHAMP Ventures consortium.	<i>Archer Capital</i>
The A\$2.9 billion deleveraging of the Alinta Energy Group including the debt for equity swap involving TPG Opportunities Partners, Oaktree Capital & Anchorage Advisers.	<i>The security trustee & agent</i>
The proposed restructure & aggregation of Centro Properties Group including the sale of US assets to Blackstone & the formation of a new listed Australian property fund.	<i>The senior lenders</i>
West Australian Newspapers' A\$4.1 billion acquisition of Seven Media Group from KKR & Seven Network Ltd.	<i>West Australian Newspapers</i>
Archer Capital's acquisition of a controlling stake in V8 Supercars Australia motorsport race group.	<i>The financiers</i>
Bright Food's acquisition of Manassen Foods from a consortium led by CHAMP Private Equity.	<i>NAB & Westpac (as financiers)</i>
Q Port Holdings (a GIP, QIC, IFM & Tawreed Investments) consortium's A\$2.3 billion acquisition of the 99-year lease of the Port of Brisbane.	<i>Q Port Holdings</i>
Providence Equity Partners' A\$660 million acquisition of Study Group.	<i>Credit Agricole, GoldmanSachs, NAB, Westpac (as financiers)</i>
The Macquarie & Carlyle Group consortium's A\$303 million proposed acquisition of Redflex Group.	<i>The Macquarie & Carlyle Group consortium</i>
Pacific Equity Partners' formation of a joint venture with Swedish personal hygiene product producer Svenska Cellulosa Aktiebolaget to invest and develop its Australasian operations.	<i>The financiers</i>
Catalyst Investment Managers Pty Ltd's acquisition of Actrol Parts, a market-leading wholesaler and distributor of refrigeration and air-conditioning systems and parts.	<i>Catalyst Investment Managers</i>

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