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Private Equity Newsletter

Summer 2009

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K&L Gates is a global law firm with lawyers in 33 offices located in North America, Europe, Asia and the Middle East, and represents numerous GLOBAL 500, FORTUNE 100, and FTSE 100 corporations, in addition to growth and middle market companies, entrepreneurs, capital market participants and public sector entities. For more information, visit www.klgates.com.

CREDIT MARKETS

Mezzanine Finance – Relative Stability in a Turbulent Marketplace

By: Philip A. Haber and T. Richard Giovannelli

The fourth quarter of 2008 saw a nearly complete breakdown of the financial system in the United States, following a storm of catastrophic events: the bankruptcy of Lehman Brothers, the collapse and bailout of AIG, the near-bankruptcy and forced acquisitions of Merrill Lynch and Wachovia, the federal seizure of Washington Mutual, the government bailouts of Fannie Mae, Freddie Mac, Citigroup, Bank of America, Wells Fargo, Morgan Stanley, Goldman Sachs and other major banking and financial institutions, along with numerous other smaller disasters in the financial services industry.

It is now well known that the crisis has rippled throughout the credit markets, resulting in a severe contraction of available credit. Syndicated bank loans for large leveraged buyouts and other corporate megadeals have largely disappeared, at least for the present, victims in part of the absence of a reliable syndication market. Gone also are the second lien loans (or “Term B loans”) that were popular until mid-2007, carrying lower pricing than traditional mezzanine loans for debt secured by subordinated liens but not subordinated in right of payment.

It is less well known that some parts of the credit market have not been as adversely affected as others. Partners in our private equity group have conducted an unscientific survey of transactions in which our clients participated as lenders, borrowers or investors during the past 12 months. The results show that there is still mezzanine financing available, especially at the lower end of the middle market, if not quite as plentiful as it was two or three years ago. Subordinated loans in amounts ranging from $5 million to $25 million can obtained from a number of capital sources, most notably independent mezzanine funds. But the mezzanine market was not unchanged by the severe disturbances in the larger credit markets.

It is clear from our survey that the pricing of mezzanine loans has been significantly affected. In the lower end of the middle market, we have seen interest rates increase by 200 to 300 basis points. Prior to last September, we typically saw interest rates on mezzanine loans in the range of 12% to 16%. Rates of 12% to 13% were common in deals where the mezzanine lender received an equity kicker such as warrants for common stock of the borrower, exercisable for a nominal exercise price. In transactions where there were no equity kickers, rates of 15% to 16% were common, often payable in cash at a rate of 12% with the rest on a pay-in-kind basis (i.e., accruing and compounded but not payable in cash until maturity). Since September of 2008, interest rates have typically varied from 14% to 19%, with rates at the lower end of this range in cases where the lender received warrants. In deals without equity kickers, we now typically see all-in interest rates of 16% to 19%, including rates of 10% to 16% payable in cash and the rest payable in kind.

Financial covenants in mezzanine financings have traditionally included a leverage test (total debt to EBITDA), a fixed charge coverage test and minimum EBITDA requirements. Current mezzanine deals still include these covenants, but lately we have also seen an increased demand by investors for minimum liquidity requirements, such as a minimum amount of total cash on hand plus senior revolver availability, and tested quarterly, monthly or even more frequently.

The current market conditions do not seem to have caused changes in payment subordination terms between senior and mezzanine debt. We continue to see traditional patterns of subordination with respect to payment terms, including limited payment bar and standstill provisions. Maturities have also generally remained in the range of five to six years. However, it now appears to be more difficult for mezzanine lenders to obtain a second lien than it was in 2007. Where a second lien is available, senior lenders are now more strident in insisting that it be a true "silent second" lien subject to onerous lien subordination terms that afford the mezzanine lenders little or no rights in the collateral, other than an ability to stand passively in line ahead of any unsecured creditors.

Some mezzanine investors believe the current market represents a historic opportunity for mezzanine investors, because many of the other traditional financing sources are currently sitting on the sidelines, not competing for deals. Many borrowers are turning to traditional mezzanine funds and other non-traditional lenders to provide senior, first lien debt. Mezzanine investors are commanding returns above historic norms and, in many cases, are able to do so while enjoying significantly lower leverage ratios and an enhanced position in the capital structure. In many such situations, we have seen intense negotiation around prepayment premiums. Borrowers are willing to pay the current premium rates, but often only do so with an eye toward refinancing out the mezzanine with a more traditional senior lender once the credit markets return to "normal."

At the same time, mezzanine investors are also coping with unprecedented challenges relating to their portfolio of investments made over the course of the past 3-5 years. Many of those deals were closed at leverage multiples at or near historic peaks. It is no surprise that most of our client contacts report that they are spending significantly more time on portfolio management issues than they are spending looking at new deals.

With the current economic decline many of those borrowers find themselves not only in default with respect to their financial covenants, but also struggling to stay current on their interest payments. As a result, we are seeing senior lenders aggressively initiating "payment blockages," which prevent borrowers from paying interest on subordinated debt. One client has remarked that yesterday's "reservation of rights letter," under which senior lenders notified a borrower of a default, but invoked no remedies, is today's "blockage notice," cutting off all cash payments to the subordinated debt. As a result, many mezzanine investors are restructuring their interest payment mechanics by increasing the amount of interest that can be paid-in-kind ("PIK interest") and decreasing the rate of cash-pay interest. Many clients also report accepting/having to accept conditional interest payment provisions, under which the mezzanine lenders agree that interest can only be paid in cash if certain financial hurdles, such as an interest coverage or minimum liquidity test, are met. Mezzanine lenders frequently are able to obtain a higher combined rate, or additional equity kickers, as compensation for such adjustments.

Because of the tightness in the credit markets, borrowers find themselves unable to refinance out senior lenders, let alone subordinated debt. Such situations highlight the potential benefit of purchase option provisions, allowing the mezzanine investor to purchase the senior debt out at par, thus enabling the mezzanine investor, at a price, to take more control of its own destiny.

In short, despite the financial storm that continues to rage around us, mezzanine deals continue to get done in the lower end of the middle market, though at significantly higher cost to borrowers.

Mr. Haber is a partner in the New York, NY office. His practice consists primarily of representation of institutional lenders and institutional investors, including hedge funds and other public and private funds, commercial banks and investment banks in a wide variety of private debt and equity financings *for acquisitions, buyouts and other purposes. These include secured and unsecured senior loans (both domestic and cross border), second lien loans, mezzanine financings, letters of credit, private equity investments and structured financing transactions. He also has experience with public and private mergers and acquisitions and general securities and corporate representation of both public and privately held companies.*

Mr. Giovannelli is a partner in the Charlotte, NC office. His practice is focused on private equity, mezzanine finance, mergers and acquisitions, and other corporate matters. Mr. Giovannelli regularly represents equity sponsors, mezzanine investors and other participants in complex buyout, recapitalization and financing transactions. He also represents the strategic investing groups at two leading money-center banks in connection with a variety of their transactions, and other companies on a variety of strategic, financing, and corporate matters.

D.C. PULSE

SBICs Benefit from the Stimulus Package

By: Martin D. Teckler

Title V of the recently enacted American Recovery and Reinvestment Act of 2009 (the Stimulus Package) provides a number of measures intended to augment the existing legislative authority of the U.S. Small Business Administration (SBA) in order to stimulate the secondary markets for SBA-guaranteed obligations and more readily provide capital to America's small businesses through SBA's existent loan and investment programs. The Stimulus Package revises and augments SBA's existing Business Lending Programs and its Small Business Investment Company (SBIC) Program; and it provides additional appropriations for purposes of implementing and overseeing the enhanced SBA programs. This article focuses on the benefits the legislation bestowed on the SBIC Program.

An SBIC is a privately-owned and operated private equity or venture capital fund which is licensed by the SBA. As a condition of licensing, SBICs are required to make long-term investments in U.S. small businesses and submit to SBA regulation. The principal reason for a fund to become licensed as an SBIC is access to financing provided by the SBA, which can enhance returns on capital invested by private sector sources.

The SBA has provided leverage to SBICs either through the issuance of "debentures" or "participating securities." Debentures are unsecured loans issued by an SBIC. Interest is payable semi-annually, such loans do not amortize and generally have a 10-year maturity. The interest rate on each debenture is permanently established when the debenture is guaranteed and sold by the SBA, and is approximately 275 basis points in excess of the interest rate on corresponding maturities of Treasury bonds. Participating securities are preferred partnership interests with no current interest obligation and 10-year maturities. The equivalent of an accrued interest rate on a participating security is generally about 240-450 basis points in excess of the corresponding Treasury bond rate. At present, the SBA is only authorized to make leverage available through the issuance of debentures. For fiscal year 2009, $3 billion of debenture financing has been authorized.

The form of leverage selected by an SBIC is primarily a function of the types of investments the SBIC will make. Debenture leverage is better suited to SBICs that invest in portfolio companies with the ability to service debt. Participating securities are better suited for SBICs investing in seed and early stage businesses or businesses that either do not have established cash flow or need to use available cash for purposes other than debt service.

SBICs obtain access to SBA financing by first obtaining a "Leverage Commitment" from the SBA and then drawing down from such commitment. Leverage Commitments may be obtained at the time an SBIC is licensed for an amount up to twice the fund's paid-in capital and binding commitments from Institutional Investors (collectively, the SBIC's Regulatory Capital). Commitments for licensed SBICs also may be obtained semi-annually.

The total amount of financing available to a particular SBIC under one or more Leverage Commitments is limited to a multiple of its paid-in private capital that depends on whether debentures or participating securities are issued. For fiscal year

2009, SBA regulations provided that the maximum amount of leverage available to an SBIC (or group of SBICs under common management) is $137,100,000. However, the Stimulus Package increases this cap. An individual SBIC may now have outstanding an amount of SBA leverage equal to the lesser of $150,000,000 or 300% of its paid-in private capital. Multiple SBICs under common control which are not capitally-impaired under SBA regulations may have outstanding at any one time an amount of SBA leverage equal to $225,000,000. If an SBIC certifies in writing to the SBA that not less than 50% of the dollar amount of its investments are made in companies located in low-income geographic areas, those amounts are increased to $175,000,000 and $250,000,000, respectively.

The Stimulus Package also requires each SBIC to certify as a condition of approval for an application for leverage from SBA that at least 25% of the aggregate dollar amount of its investments shall be made in smaller enterprises. The requirement had been 20%.

Finally, the Stimulus Package makes adjustments in the amount of capital an SBIC can invest in a single small business – now limited to 10% of the sum of its paid-in private capital and the total amount of leverage projected in its SBA-approved business plan at the time of its licensing as an SBIC. This effectively increases the amount of capital an SBIC may invest in a single business over the preexisting limit of 20% of Regulatory Capital.

Mr. Teckler is a partner in the firm's Washington, D.C. office and is experienced in general corporate law, real estate, administrative law, securities and venture capital. He also has experience in the programs of the Small Business Administration and other federal agencies which provide capital to small businesses, such as the U.S. Department of Agriculture, OPIC and the Export-Import Bank, and in the areas of government contracting and the provision of set asides to small and minority-owned businesses.

Recent Developments in Fund Taxation

By: Roger Wise

Taxing Carried Interest as Ordinary Income

President Obama was elected on a platform of change, and his budget proposes to bring change to private equity funds by taxing carried interest as ordinary income.

Although the Obama carried interest proposal is similar to versions introduced in Congress over the past few years, the Obama proposal makes one fundamental change – applying the proposal to <u>all</u> partnerships, and not merely to investment funds and similar entities.

The general partner of a private equity fund typically receives a disproportionately large share of fund profits – generally 20%, as compared to the general partner's committed capital, which is generally as little as 1-3%. This profits interest is often referred to as a "carried interest" because the limited partners, through their capital contributions, are "carrying" the general partner. Under current law, the holder of a "carried interest" in a fund is generally respected as a partner, and thus enjoys flow-through treatment of partnership items that are allocated to such holder. If the fund's income consists of long-term capital gains, the portion of fund profits allocated to the general partner with respect to the carried interest will be taxed as long-term capital gains. For individuals, this type of income is subject to tax at a maximum rate of 15%, versus a top rate of 35% for compensation income.

For proponents of the carried interest proposal, the central objection to the treatment described above is that the general partner receives his interest in the fund in respect of services, and yet is not taxed in the same manner as other service providers (to the extent the fund generates long-term capital gains). The counter-argument is that the law has been settled for some time that a service provider who receives a profits interest in a partnership is treated as a partner, and income allocated to a partner as part of his or her distributive share of partnership income retains the character (as ordinary income or capital gains) determined at the partnership level.

The carried interest proposal would represent a fundamental change to the fabric of the partnership rules and – however one feels about the justification for this change in the context of fund managers – would almost certainly have unintended or unexpected consequences in other contexts. These unintended consequences could be even more far-reaching given the Obama Administration's expansion of the proposal to all partnerships.
The carried interest proposal would treat allocations with respect to any interest that a partner receives for services to the partnership – a "services partnership interest" – as ordinary income rather than (if applicable) capital gains. In addition, the partner would be required to pay self-employment taxes on this income, and the gain recognized on the sale of such an interest (to the extent not attributable to amounts invested in the partnership by that partner) would generally be taxed as ordinary income. Prior versions of the carried interest proposal had only applied to an investment services partnership interest, which was defined as any interest held by a person who provides (directly or indirectly) a substantial quantity of certain asset management services to the partnership in the conduct of a trade or business. The carried interest proposal, if enacted, would not be effective until 2011.

One unknown is whether (and how) the proposal will attempt to address possible structures to circumvent the new rules. For example, the proposal (like previous bills introduced in Congress) contains an exception for invested capital, so that a general partner will still be eligible for capital gains treatment with respect to the return on the investment of the general partner's own capital in the fund. The proposal (like these bills) then makes clear, however, that invested capital treatment would not be available if the general partner borrowed the invested capital or received a guarantee from the other partners, the partnership, or anyone related to a partner or the partnership. The proposal also picks up on attempts in the previous bills to prevent the use of other entities, such as offshore funds, to create an arrangement like a carried interest. For example, if a person performs services for another type of entity, holds an equity or similar interest (contingent or convertible debt, option, derivative) in the entity, and the value of the interest is substantially related to the amount of realized or unrealized income from the assets with respect to which the services are performed, then gain on the sale of the interest and dividends received with respect to that interest would be taxed as ordinary income.

Section 457A Eliminates Deferral of Fees

The Emergency Economic Stabilization Act of 2008, which was signed into law on October 3, 2008, added Section 457A to the Code. Although this provision was primarily aimed at fee deferrals from offshore hedge funds, it can affect other types of funds and their managers.

Section 457A effectively ended the ability of hedge fund managers to defer tax on fees from most offshore funds starting in 2009, although investment managers were generally permitted to continue deferring tax on previously earned fees for a period of up to 9 years (until the last taxable year beginning before 2018). Section 457A, however, can apply beyond the hedge fund context.

For a more detailed discussion of this provision, *see* "Managers Will No Longer Be Able to Defer Fees From Most Offshore Funds Starting in 2009," *Hedge Fund/Private Equity Fund Alert*, by Roger S. Wise, October 13, 2008.

Mr. Wise is a partner in the firm's Washington, D.C. office. Mr. Wise advises clients on the tax aspects of structuring open-end and closed-end mutual funds, hedge funds and private equity funds. Recent matters include master-feeder structures, fund-of-funds strategies, tax-free reorganizations of investment companies, and complex reorganizations involving partnerships. Mr. Wise's experience also includes structuring and negotiating corporate acquisitions and divestitures, including leveraged buyouts, internal reorganizations and inbound and outbound investments.

Reform Efforts Target Hedge Fund and Private Equity Fund Regulation

By: Daniel F. C. Crowley and Karishma Shah Page

Congress and the Obama Administration are focusing their attention on reform efforts that will fundamentally reshape the financial services industry. Apprehension about systemic risk has placed regulation of hedge funds and private equity funds at the top of the reform agenda. Although past attempts at hedge fund regulation have been unsuccessful, there is now a growing consensus in Washington, D.C. and abroad that hedge fund and private equity fund regulation, in light of the particularly grave downturn, is now necessary. Citing their size and use of leveraging, policymakers and economists note that these "dark pools" of capital create systemic risk due to their ability to potentially destabilize the entire market.

On March 26, 2009, the Treasury Department released its Framework for Regulatory Reform. Building on other recent efforts, the G30 also released a report in January 2009 recommending similar regulatory reforms (see G30 Financial Reform: A Framework for Financial Stability). Notably, one of the primary authors of the G30 Report was former Federal Reserve Chairman Paul Volcker, who now serves as one of President Obama's economic advisors and the Chairman of the President's Economic Recovery Advisory Board. Other members of the G30 include Larry Summers, who is now Director of the National Economic Council at the White House, and Tim Geithner, who is now Secretary of the Treasury.

The Treasury Framework consists of four main components: (1) addressing systemic risk; (2) protecting consumers and investors; (3) eliminating gaps in the regulatory structure; and (4) fostering international coordination. The March 26th Treasury release focused primarily on the first of the four components—addressing systemic risk; information on the other components will be released at a later date.

The Framework proposes requiring all private pools of capital above a certain size to register, including hedge funds, private equity funds, and venture capital funds. More specifically, the Framework recommends:

- All advisors to private pools of capital whose assets under management exceed a certain threshold be required to register with the SEC;
- All such funds be subject to investor disclosure and regulatory reporting requirements, including information necessary to assess whether the fund poses a threat to financial stability;
- The SEC be required to share reports with a systemic risk regulator, which would then determine whether the fund could pose a systemic threat; and
- Private pools of capital posing a systemic threat should be subject to strict capital, liquidity, counterparty, and credit risk management requirements.

Congress has also started to consider legislation regulating hedge funds. On January 29, 2009, Senators Chuck Grassley (R-IA) and Carl Levin (D-MI) introduced S. 344, the Hedge Fund Transparency Act. Although similar to legislation previously introduced by Senator Grassley in the previous Congress, S. 344 amends the Investment Company Act of 1940 (ICA), rather than the Investment Advisers Act of 1940. Among other provisions, the bill would change the definition of an investment company. If a company meeting the new definition has assets under management of $50 million or more, the bill requires that the company: (1) register with the SEC; (2) file an annual disclosure with the SEC; (3) comply with SEC record-keeping standards; and (4) cooperate with SEC examinations or requests for information. Notably, the Grassley-Levin legislation does not require the establishment of capital, liquidity, and risk management standards which have been recommended by the Treasury Framework and the G30 Report.

Congressman Michael Castle (R-DE) has also introduced two bills impacting the hedge fund industry. H.R. 711, Hedge Fund Adviser Registration Act of 2009, would remove the registration exception for certain investment advisors with less than 15 clients, thereby eliminating the registration exemption available to many hedge fund advisors. H.R. 712, Pension Security Act of 2009, would require an annual report by defined benefit pension plans disclosing plan investments in hedge funds. Further consideration of either bill as a stand-alone measure is unlikely. However, additional bills focusing on studies and investigations of the hedge fund industry have also been introduced and we expect many of these concepts to be incorporated in broader legislation to come.

Regulation of hedge and private equity funds has also taken on an international dimension in recent months. Both the Treasury Framework and the G30 Report recommend that a regulatory Framework be applied on an internationally harmonized basis. At the London Summit in April, leaders of the G20 agreed to extend regulation and oversight to all systemically important financial institutions, instruments, and markets, including hedge funds.

The K&L Gates public policy group is closely monitoring these developments on behalf of the firm's policy clients.

INVESTORS' CORNER

Private Equity Funds, Illiquidity and the Denominator Effect

By: Ricardo J. Hollingsworth and Charles H. Purcell

Historically, the ranks of institutional investors in private equity funds have been dominated by a relatively small number of public and private pension plans, foundations and endowments. The vast majority of their institutional counterparts were content to invest their assets in public securities, usually through third-party investment managers. However, as the institutions that invested in private equity began to show significantly increased returns and as the public markets foundered over the last decade, a broader group of institutional investors has come to embrace alternative investments generally, and private equity specifically, as integral parts of a diversified portfolio. This led to a significant expansion in the number of institutional investors seeking to invest in private equity and a period of unprecedented growth in the asset class. In 2007, private equity funds raised almost $500 billion.

The turmoil in the credit markets beginning in 2008 and its attendant effects on both the public securities markets and the private equity market have strained the private equity portfolios of institutional investors in two respects - portfolio allocations and liquidity. As a result of the recent declines in value of institutional investors' public equity holdings, their proportional holdings in private equity and other illiquid investments in many cases are higher than originally allocated. This denominator effect, so named because the decrease in the value of public equity holdings causes a decrease in the value of the investors' overall portfolio (the denominator), which in turn causes the private equity portion of the portfolio (the numerator) to account for a disproportionately large part of the overall portfolio, causes over-allocation to the private equity asset class.

The problem has been exacerbated by the fact that valuations of private equity investments, given their illiquid nature, have trailed declining valuations in the public equities markets. This effect may be ameliorated to some degree by FAS 157, which requires private equity firms to "mark their assets to market." The mark to market rule will take into account public company comparables, effectively importing the decline in value of public assets into private equity portfolios. The focus of FAS 157 on current market prices will also effectively depress valuations.

Certain institutional investors (principally endowments) have begun rebalancing their portfolios in order to bring their private equity allocations within range of their original allocation targets. This is one reason why several very large university endowments have reportedly put up for sale parts of their private equity portfolios in the secondary market and others have reportedly refused to meet capital calls.

Liquidity concerns are also affecting institutional investors in private equity. The frozen credit markets have prevented private equity firms from liquidating investments in their portfolio companies through leveraged recapitalizations, sales to strategic buyers or public offerings. This has slowed distributions from private equity firms to their investors. Emerging as we are from an unprecedented period of private equity fund raising, many institutional investors have concluded that the expected payouts from their existing private equity investments may not be enough to meet their commitments to invest in new private equity funds to which they have recently committed. This decrease in liquidity, which is made more severe by the drop in the value of the liquid, public equity portions of their portfolios, is adding to the pressure on endowments trying to fund university operating expenses and pension funds facing benefit obligations.

Taken together, the denominator effect and the decrease in the availability of leverage could lead many traditional institutional investors to reduce their investments in private equity funds, which potentially signals a period of smaller fund sizes in the private equity industry. However, there are indications that the foreign investors, endowments and pension funds that are ramping up their private equity programs may be making up some of the shortfall in investing.

Mr. Hollingsworth is a partner in the firm's New York, NY office and represents private equity firms and institutional investors in connection with their fund formation and investment activity. He also has extensive experience in private equity transactions, mergers and acquisitions, corporate partnering transactions, strategic investments, private placements and corporate finance, including secured and unsecured debt financing transactions.

Mr. Purcell is a partner in the firm's Seattle office. His practice encompasses federal and international tax issues involving foreign and domestic clients, and he works extensively in the private equity arena. He has experience in numerous areas including mergers and acquisitions, both domestic and cross-border; inbound and outbound investment structures; financing and banking transactions; bankruptcy tax issues; financial products; taxation; venture capital investments and start-up companies; foreign and domestic investment companies (including registered investment companies and real estate investment trusts); and compensation of executives and promoters in the foreign and domestic contexts.

PORTFOLIO OPERATIONS

Layoffs and Laments

By: Linda L. Usoz

Companies have laid off employees with alarming speed in an effort to cut costs and weather this latest and most dramatic downturn. The federal WARN Act mandates notice requirements to employees in the event of a mass layoff (defined below) or certain plant closings. The Act has been in existence for 20 years and companies have long been aware of its requirements, having gained experience in complying with the law through at least one or two recessions. What has changed, however, is that over the last decade, *16 states* have enacted their own "WARN Acts" that employers in those states must also follow; New York and New Jersey were the two most recent states to add "WARN Acts," and they join California and thirteen other states that have imposed different or additional requirements on employers seeking to reduce their workforces.

The federal WARN Act covers employers with at least 100 full-time employees. It defines a "mass layoff" as a layoff of 50 to 499 employees within a 30-day period at a single site, provided the number laid off constitutes at least 33% of the employees at such site. A layoff of 500 or more employees is automatically considered a "mass layoff," regardless of percentage. Also, there is a 90-day look-back/look-forward to prevent employers from staging layoffs intermittently in an effort to avoid WARN Act coverage. Covered employers are required to provide 60 days' advance notice of layoff, and provide specific information to various governmental authorities. Employers who fail to comply with the notice requirements face liabilities to each affected employee equal to the wages and benefits he or she would have received if notice were provided.

Many state laws have broader coverage than the federal WARN Act and impose different or more extensive notice requirements. While the federal WARN Act applies to employers with 100 or more full-time employees, California's "WARN Act" applies to any establishment with 75 or more full-time or part-time employees. A layoff affecting 50 or more employees, regardless of percentage of workforce, automatically triggers California's "WARN Act" coverage. New York's "WARN Act" can apply to employers with as few as 50 employees. A layoff of 25 or more employees constituting 33% or more of the workforce, or a layoff of 250 workers, regardless of percentage, triggers coverage. And while both California and federal law require only 60 days' advance notice, New York's "WARN Act" mandates *90 days'* advance notice.

While the form of notice under New York's and California's "WARN Acts" is substantially the same as that required by the federal WARN Act, New Jersey's new "WARN Act" imposes additional requirements. Unlike California and New York, New Jersey requires that workers be informed in writing of other employment opportunities that may exist at other establishments operated by the same employer. New Jersey also requires that each individual employee covered by a collective bargaining agreement be given notice. In contrast, the federal WARN Act mandates that notice be given only to the union in such situation.

There are 13 other state "WARN Acts" not discussed above. All vary and may have broader coverage than the federal WARN Act, and may impose very different requirements than the federal WARN Act. It is not enough to assume that if a particular layoff is not covered by the federal WARN Act, there is no coverage under state laws.

Many employers elect to provide the 60 days of pay and benefits in lieu of notice under the federal WARN Act for various reasons (including fear that advance notification would cause other issues or interfere in a pending transaction). While the U.S. Department of Labor does not condone such action, it recognizes that providing the required pay and benefits payoff effectively precludes any claims by affected employees. State laws may not be as forgiving. For example, an employer who fails to provide the required 60 days' notice under New Jersey's "WARN Act" must pay its employees severance pay equal to one week of pay for each full year of employment, *in addition to* any severance payment provided by the employer pursuant to a collective bargaining agreement or other reason (such as policy or practice).

Private equity owners are well-advised to have portfolio companies obtain competent legal advice whenever contemplating reductions in force and plant closings. A small investment in the appropriate advice may avert an unpleasant and costly surprise later.

Ms. Usoz is of counsel in the firm's Palo Alto, CA office and primarily represents public, private and start-up companies in all aspects of employment law as well as a wide variety of commercial matters.

INDUSTRY FOCUS

Emerging Health Law Trends: Challenges and Opportunities for Private Equity Sponsors

By: Jonathan K. Henderson

Healthcare issues are running the headlines. Our nation's economic troubles have been generally blamed on a broken healthcare system. President Obama promised change during his campaign, and despite unprecedented global economic distractions, appears to be staying on course. Segments of the healthcare industry have been targeted as responsible for rising governmental healthcare program spending. The various healthcare reform proposals promoting change directly or indirectly cover most aspects of the delivery of and payment for healthcare in the U.S. The waters are muddy to say the least.

Healthcare is a complex, highly competitive, socially rewarding and historically profitable business sector. Investors have generally viewed the industry as counter-cyclical. The healthcare industry in the U.S. was reported to represent about 16.5% of the GDP in 2008. It is predicted to grow to 19.6% by 2016. This represents the slowest growth rate in years, but unlike many other sectors of the economy, healthcare is still growing. During the first quarter of 2009, healthcare added jobs while other sectors shed jobs at record-busting levels. During a general economic downturn, if history is followed, healthcare will increase as a relative percentage of GDP.

Against this backdrop of uncertainty, private equity sponsors invested in the healthcare industry must continue to work with their portfolio companies' management teams to design, evolve, adapt and execute business plans. Private equity techniques focus on cost-cutting, improving efficiencies, best management practices and systems, robust legal and regulatory compliance, diligence in accounting and financial reporting and being early adopters of technology and other tools to enhance operations, all leading to better operating companies delivering better quality services at lower costs compared to perhaps less well-managed companies.

There are four emerging health law trends that private equity sponsors in healthcare will need to traverse as the U.S. healthcare system finds its equilibrium during the Obama presidency:

1. ***Healthcare System Reform***. There is now more momentum for healthcare reform in the U.S. than perhaps any other time in history. Regardless of the shape reform ultimately takes, there are going to be new and amended statutes, regulations and rules implementing whatever changes are made in the delivery of and payment for healthcare. It is likely that all participants in the healthcare system, including physicians, hospitals, surgery centers, imaging centers, laboratories and other providers and suppliers, pharmaceutical manufacturers and distributors, and commercial and governmental payers, will have new or modified statutory and regulatory obligations affecting their operations, reimbursement, physician and other business relationships, and liabilities. Various state governments are also enacting their own healthcare reform measures, creating a patchwork of laws affecting the compliance efforts of multi-state healthcare companies.

2. ***Quality of Care***. The U.S. spends more on healthcare than any other country in the world. However, studies have shown that other advanced nations have outperformed our system on quality, access, efficiency, equity and healthy life measures. This chasm between cost and quality is beginning to be addressed -- for example, by CMS not paying hospitals for "never events" -- and most analysts agree that "pay for performance" policies will continue to be an emphasis for governmental as well as private payers. The statutory and regulatory changes resulting from this focus on quality of care will impact regulatory and reimbursement compliance as well as malpractice liability for providers and suppliers.

3. ***Health Information Technology***. As envisioned by Obama's healthcare team, health information technology is a foundational part of both healthcare system reform and quality of care improvement. There will be new business opportunities created by the significant funding targeted at expanding health information technology, but also coinciding with increased legal and regulatory compliance issues from the privacy and security issues involved in electronic health records, e-prescribing and health information networks and exchanges.

4. ***Fraud and Abuse Enforcement.*** Fraud and abuse is blamed for much of the excessive costs and waste in government spending on healthcare. It is expected that an attack on fraud and abuse will be part of any healthcare reform. Several U.S. legislators and President Obama's recently-confirmed head of the U.S. Department of Health and Human Services are diligently focused on physician, drug company and other relationships among healthcare industry providers and suppliers as sources of costly fraud and abuse. If reform expands government's role as payer for healthcare services, we should expect a generally sharper regulatory focus along with specific increased scrutiny of physician, hospital, pharmaceutical manufacturer and distributor, and certain other provider and supplier relationships.

To successfully respond to the challenges and take advantage of the opportunities from these emerging health law trends, private equity sponsors invested in healthcare will need to stay abreast of proposed and enacted statutes, regulations and rules. They must also engage in the public debate surrounding reform and participate through their legal counsel and public policy advisors, trade associations and other representatives in the legislative and regulatory processes.

Mr. Henderson is a partner in the firm's Fort Worth, TX office and focuses on the representation of physicians, hospitals, home health agencies, nursing homes, pharmaceutical manufacturers, and other healthcare industry providers and suppliers on a broad range of transactional and regulatory matters. You may also want to read Jon's article entitled, "The Patient is Doing Well", published in The Deal Magazine at www.thedeal.com on January 9, 2009. The article focuses on the positive impact of private equity investing on the healthcare industry in the Southwestern U.S.

WHAT'S NEW

K&L Gates' Private Equity Practice Among Industry's Ten Most Active in 2008

In May of this year, *Dow Jones Private Equity Analyst* released its private equity law firm rankings for 2008. K&L Gates topped the list as one of the ten leading law firms worldwide in terms of the number of private equity and venture capital deals and funds represented in 2008.

Specifically, K&L Gates ranked sixth in the number of private equity and venture capital deals negotiated and closed in 2008, having completed a total of 357 deals. Additionally, the firm ranked eighth on the publication's list of most active law firms based on the number of private equity or venture capital funds formed, with 193. Both rankings show solid increases from 2007, when K&L Gates was ranked sixteenth based on the number of deals and eleventh in the number of funds formed.

While the publication does not specifically rank firms based on separate numbers of private equity or venture capital deals represented or by work for general or limited partners in the formation of funds, K&L Gates' 250 private equity deals during 2008 made the firm the second most active in terms of private equity deals. The firm also ranked fourteenth overall in venture capital deals closed, and sixth for representation of limited partners in fund formations.

"K&L Gates is fortunate to serve capital market and company-side clients across a wide range of industries - and types and sizes of transactions - in their private equity, venture capital and fund formation needs," said K&L Gates corporate practice area leader Robert P. Zinn. "The ability to pick up significant market share during these extremely challenging times is a reflection of the full market capabilities, interdisciplinary nature, and strong value proposition of our firm's global platform."

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