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Proposed Senate Bill Would Significantly Impact Certain Private Funds and Their Affiliates

The Capital Commitment Blog on **September 4, 2019**

Recently, a group of Congress members introduced into Congress Senate Bill 2155 named the Stop Wall Street Looting Act of 2019. Although unlikely to be enacted into law as drafted, this proposed legislation would directly and substantially affect a number of fundamental operational aspects of private equity funds and their affiliates. The proposal, co-sponsored by a number of Democratic members of Congress, is the latest iteration of periodic legislative efforts to "rein in" perceived abuses in the private equity industry.

To summarize several key areas of Senate Bill 2155:

- Sections 101 and 102 would hold private funds that are control persons of a portfolio company jointly and severally liable for all debt incurred by the portfolio company;
- Section 103 would provide that any indemnification of a private fund that is a control person, or an affiliate thereof (defined to include 20% or greater beneficial owners), for the liabilities of a portfolio company and its affiliates is void against public policy;
- Section 201 would prohibit portfolio companies from making a capital distribution during the 24 months following a leveraged buyout transaction;
- Section 203 would apply a 100% tax on fees paid by portfolio companies to private fund managers, such as "monitoring" or "transaction" fees;
- Section 403 would tax carried interest, currently taxed at the preferential capital gains rates at the higher earned income rates;
- Section 501 would require the SEC to issue rules requiring each private fund to make certain annual public disclosures including the identities of those with interests in the fund and their ownership interests, the debt held by the fund (disaggregated by both domestic versus offshore and financial institution verses non-financial institution creditors) its portfolio companies (including portfolio company debt categorized as liabilities, long-term liabilities, and payment in kind or zero coupon debt), the performance of the portfolio companies, and fees and

payments collected by the firm; and

- Section 502 would prohibit investment advisers, including private fund managers, from requiring investors (including pension plans) to waive the fund managers' fiduciary duty under ERISA or under the Investment Advisers Act of 1940.

Additionally, for purposes of Senate Bill 2155, Section 3 defines a "private fund" as a company or partnership relying on either section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (but expressly excluding venture capital funds) that directly, or through an affiliate, acts as a control person of an entity that is acquired in a change in control transaction (e.g. a portfolio company). Section 3 further defines the term "control person" as someone who owns or controls, including through coordination with other persons, at least 20% of voting securities of a company, but excludes limited partners of a private fund organized as a partnership.

Reactions from the private fund industry to date have understandingly varied. On July 18th, American Investment Council President and CEO Drew Maloney issued a statement characterizing Senate Bill 2155 as both "harmful" and "extreme." Subsequently, a Pensions & Investments article dated August 5th reported that the Institutional Limited Partners Association "support[ed] some of the legislation's ideas but it also look[ed] forward to House hearings and more bipartisan legislation later this year.

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