

Freedom of Information Act Clarification for Private Equity Portfolio Company Information

Issue Summary

Legislation protecting the commercially sensitive information of companies that receive private equity funding from public pension funds was enacted in Illinois in August 2005. The legislation clarifies the existing protection of this sensitive commercial or financial information under the trade secrets provision of the state's Freedom of Information Act (FOIA) explicitly exempts from FOIA requests trade secrets and commercial or financial information obtained from a person or business where such information is proprietary, privileged, or confidential, or where disclosure of the trade secrets or information may cause competitive harm, including:

- (i) All information determined to be confidential under Section 4002 of the Technology Advancement and Development Act.
- (ii) All trade secrets and commercial or financial information obtained by a public body, including a public pension fund, from a private equity fund or a privately held company within the investment portfolio of a private equity fund as a result of either investing or evaluating a potential investment of public funds in a private equity fund. The exemption contained in this item does not apply to the aggregate financial performance information of a private equity fund, nor to the identity of the fund's managers or general partners. The exemption contained in this item does not apply to the identity of a privately held company within the investment portfolio of a private equity fund, unless disclosure of the identity of a privately held company may cause competitive harm.

This legislation was introduced early in 2005 by Senator Don Harmon and co-sponsored by Senators Kirk Dillard and Dan Rutherford. The Senate passed it unanimously on April 14th. The bill was then taken up by the House (sponsored by Representative Kurt Granberg) and passed the House by a vote of 112 to 3 on May 18th. With the governor signing it into law on August 8th (Public Act 94-0508), Illinois joined five other states – Massachusetts, Colorado, Michigan, Virginia, and Texas – in enacting laws to provide transparency in public investments in private equity without damaging portfolio companies' ability to compete.

Background

A great deal of attention has been focused on the issue of public disclosure of confidential commercial or financial information relating to private equity funds through FOIA requests made primarily to public pension funds.

While in theory this sensitive information is protected, most FOIA statutes are silent on the release of private equity portfolio company information (information pertaining to the individual companies in which a private equity fund invests). For example, when a public entity, such as a state employee pension fund, invests in a private equity fund, it often receives extremely confidential commercial and financial information about the private companies in which the fund invests. Were these private companies governed by the Securities and Exchange Commission (SEC), they would not be required to report the type of sensitive information that is shared with investors or potential investors in the private equity fund, such as management performance reviews, strategic plans, potential acquisitions, and the like.

Although adequate protection from public disclosure of this confidential and sensitive commercial and financial information should be found in the trade secrets provisions of most states' FOIA laws, in practice, this protection is ambiguous. This ambiguity has resulted in a number of costly lawsuits against major public pension funds across the country. It has also resulted in a number of leading private equity firms prohibiting some pension funds from investing in their funds and requesting those pension funds already invested in their private equity funds to withdraw.

For example, according to a 28 August 2003 *Wall Street Journal* piece, following a state court ruling in 2003 requiring such disclosure, Sequoia Capital told the University of California system that it would be dropped from the firm's latest fund. The private equity firm also asked the university to divest itself of any Sequoia holding in which the school is an investor. The university had a 22-year relationship with Sequoia and is planning to appeal the court ruling. And according to the June 2004 *Venture Capital Journal's* "From the Editor" column, Benchmark Capital, Charles River Venture Partners, Sequoia Capital, and Woodside Fund (all leading VC firms) have chosen not to pursue public money for their latest funds.

This refusal by private equity firms to accept public pension funds as investors harms both the pension funds – which lose potentially attractive alternative investment opportunities – and private equity funds, which are deprived of access to an important source of capital funding.

Legislation to Provide an Appropriate and Workable Balance

Private equity firms are not required to publicly disclose any financial information. They provide it to their investors as part of the investors' evaluation of current and prospective investments. This includes top-level information (such as aggregate fund-level performance data) as well as very sensitive individual company data (such as strategic plans, new product launches, individual management performance reviews, potential mergers and acquisitions, and the like).

Public reporting becomes an issue only when public entities subject to FOIA, such as public pension funds, want to invest in attractive private equity funds. Private equity firms have the option of dealing with the ambiguity of FOIA or of simply refusing to take public funds into their private equity funds. Many have chosen the latter option.

To ensure that Illinois public pension funds retained access to private equity investments, IVCA worked with legislators to develop an appropriate balance between the public's right to information and the ability of public entities to invest in attractive alternative investments, such as private equity funds, by demanding the disclosure of aggregate fund-level performance while protecting individual company proprietary information. This proposal was introduced as S.B. 52 which became Public Law 94-0508 in 2005.

IVCA believes that this legislation reflects an appropriate compromise in that it provides the public with a meaningful performance measure while not placing companies in which the fund invests at a competitive disadvantage, thus threatening future growth. It also allows public funds much needed access to competitive alternative asset investments.