

Role of the General Counsel in Investment Transactions

Perspectives from internal and external legal counsel
and an investment professional



Is there a need for Investment Counsel?

- Does your fund have an Internal/General Counsel?
- Does the General Counsel have access to external counsel?
- Does your General Counsel have investment expertise?

View from the Investment Professional

- Why do I want a lawyer dedicated to my needs?
- What types of work do I want the lawyer to perform?
- What are the advantages?
- In-House, External, Both? Who gets what?
- How do I justify the expense?



View from Internal Counsel

- What are the expected day-to-day interactions with staff?
- What value is added to the Investment team by hiring internal counsel?
- How do I develop the requisite knowledge and stay abreast of trends?
- When do I cry, “Uncle!” and turn to outside counsel?
- Tools used to evaluate legal and business risks.



Microsoft Excel
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Rating Report – Summary for Sample Investment

Total Points for Sample Investment: 163.26 of 246

Fund Type: Distressed

Geography: North America

Size (in USD): 500 – 1 billion

Emerging Manager: no

Vintage Year: 2014

Alignment of Interest	Points	% Compliance
Carry/Waterfall	47.71 of 51	93.55%
Management Fee and Expenses	12.6 of 23	54.78%
Term of Fund	2.4 of 4	60%
General Partner Fee Income Offsets	4 of 10	40%
General Partner Commitment	8.5 of 25	34%
Standard for Multiple Product Firms	10 of 20	50%
Total Points for Alignment of Interest	85.21 of 133	64.07%

Governance	Points	% Compliance
Fiduciary Duty	28.64 of 41	69.85%
Investment Strategy	6 of 12	50%
Changes to the Fund	5 of 6	83.33%
Stronger No-Fault Rights and Withdrawal Rights	12 of 20	60%
Independent Auditor and Independent Fund Counsel	12 of 15	80%
Team	14.4 of 16	90%
Limited Partner Advisory Committee	0 of 3	0%
Total Points for Governance	78.04 of 113	69.06%



View from Outside Counsel

- Can I provide insight on market practices and trends?
- Do I have the resources and expertise in targeted areas of need?
- Are there legal risks in these transactions that we are unable to completely avoid?
- What are the legal and regulatory requirements that must be met?
- Is there political or headline risk that you're not identifying?



Making the Relationships Work

- Rule # 1 – avoid an antagonistic relationship
- Respect turf – lawyer as the advisor and not the final decision-maker
- Keep everyone in the loop on major issues to avoid surprises (or making any one appear to be incompetent)

Section	Sub Section	Question	Answer / Score	Guide	Note
Alignment of Interest			85.21		
	Carry/Waterfall		47.71		
		The waterfall structure is a standard all-contributions -plus-preferred-return-back-first model	Yes	All or nothing.	
		The preferred return is calculated from the day capital is contributed to the point of distribution.	Yes	All or nothing.	
		Carried interest is calculated on the basis of net profits (not gross profits).	Yes	All or nothing.	
		No carry is taken on temporary investment income.	Yes	All or nothing.	
		Carry is paid on current income or recapitalizations once full amount of invested capital is realized on each investment that was recapitalized.	3	5 = Carry paid only after full amount of invested capital is realized 2 = Partial distribution treatment 0 = Straight to 80-20 split	
		Carried interest is calculated on an after-tax basis (i.e., foreign or other taxes imposed on the fund should not be treated as distributions to the partners).	Yes	All or nothing.	
		Clawbacks are created so that when they are required they are fully and timely repaid.	7	10 = Interim clawback test at end of investment period and every year or two thereafter and on key-man event and NAV coverage of 125% test 8 = All elements of the above, but either NAV test is on current value or no key-man test 6 = Interim clawback test at year 8 and NAV coverage test is 125% 4 = Interim clawback test at year 8 and NAV coverage test at current value	
		Clawback period extends beyond the term of the fund, including liquidation and any provision of LP giveback of distributions	Yes	All or nothing.	
		Actual and potential clawback liabilities, if any, are determined and clearly disclosed to the limited partners as of the end of every reporting period. The disclosure will be accompanied by a plan by the general partner to resolve the clawback.	Yes	All or nothing.	
		All clawback amounts are net of taxes paid, but the tax liability to be offset should take into account loss carryforwards and carrybacks, the character of fund income and deductions attributable to state tax payments, any ordinary deductions or losses as a result of any clawback contribution or capital account shift, and any change in taxation between the date of the LPA and the clawback. Any tax advances made to the GP should be returned immediately if in excess of the actual tax liability so that the GP does not profit from the LPs' willingness to bear their tax liabilities.	3	5 = Tax carveout is only for taxes actually paid and not recoverable and considers all of the factors. 3 = Tax carveout is only for taxes actually paid and not recoverable but does not consider all factors 0 = Hypothetical tax rate and/or do	
		There is an ability to fix the clawback formula in order to avoid material errors in stipulated formula which would cause the clawback amount not to equal the lesser of excess carry or total carry paid, net of actually paid taxes. The tax amount should not simply be subtracted from the amount owed under the clawback, and the clawback formula should take the preferred return into account.	3	5 = Tax amount not subtracted from amount owed, and preferred return taken into account 3 = One of the foregoing, but not the other 0 = None	
		Sufficient security stands behind the clawback obligation.	7	10 = Joint and several 7 = Several up to 150%; all participants sign a guarantee 5 = Creditworthy entity guarantee 1 = Several only (In order to fully score this category, it is likely that one will need to look at the guarantee.)	
		LPs have robust powers to enforce the clawback against individual GPs.	3	5 = LPs can enforce guarantee and no amendments to guarantee permitted absent LP vote 2 = LPAC can enforce guarantee and no amendments to guarantee permitted absent LPAC vote (In order to fully score this category, it is likely that one will need to look at the guarantee.)	
Management Fee and Expenses			12.6		
		The General Partner will provide prospective limited partners with a fee model for the fund at formation to be used as a guide to set management fees.	Yes	All or nothing.	
		Management fees take into account the lower levels of expenses generally incident to the formation of a follow-on fund.	2	5 = Management fees cease entirely 3 = Fees otherwise stepped down	
		Management fees take into account the lower levels of expenses generally incident at the end of the investment period.	3	5 = Fee % reduced and basis reduced (or, for fund <\$750M, basis reduced) 3 = Basis reduced only (fund >\$750M)	
		Management fees take into account the lower levels of expenses generally incident during term extensions.	Yes	All or nothing. Management fees should cease during extensions.	
		The management fee encompasses all normal operations of a general partner to include, at a minimum, overhead, staff compensation, travel, deal sourcing and other general administrative items as well as interactions with limited partners.	1	5 = 100% compliant 1 = LPs bear travel and reporting	
		The Limited Partner Advisory Committee will review partnership expenses annually.	No	All or nothing.	

		Placement agent fees will be an expense borne entirely by the general partner.	Yes	All or nothing. [Note: if placement fees are offset from the management fee, then the score should be zero.]	
Term of Fund				2.4	
		Fund extensions are permitted in 1 year increments only and are to be approved by a majority of the LPAC or LPs.	1	5 = GP may extend with LP vote 3 = GP may extend with LPAC vote 0 = GP may extend without vote	
		Absent LP consent, the GP must fully liquidate the fund within one year following expiration of the fund term.	Yes	All or nothing.	
General Partner Fee Income Offsets				4	
		All transaction, monitoring, directory, advisory, exit fees and other consideration charged by the general partner accrue to the benefit of the fund, net of any unreimbursed expenses.	2	5 = 100% of fees to fund 3 = 100% of fees offset management fee 1 = 80% of fees offset management fee 0 = <80% offset	
General Partner Commitment				8.6	
		The general partner has a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners.	1	This is subjective but can be heavily influenced by modeling. Factors include, but are not limited to, the number of funds managed currently or historically, the amount of deal fees, the net worth of the principals, etc. For aid in determining the appropriate score, please refer to the ILPA GP Economics Model.	
		The general partner's equity interest will be cash as opposed to being contributed through the waiver of management fees.	2	5 = 100% of GP interest in cash 1 = Between 25% and 50% of GP interest in cash 0 = <25% of GP interest in cash	
		Principals are restricted from transferring their interest in the general partner in order to ensure alignment with the limited partners.	3	5 = No transfer without LP consent 3 = No transfer of more than 25% without LP consent (Consider estate planning?)	
		The GP will not co-invest in select underlying deals, its equity interest is through the fund.	No	All or nothing.	
Standard for Multiple Product Firms				10	
		Key-persons will devote substantially all their business time to the fund, its predecessors and successors within a defined strategy, and its parallel vehicles.	4	5 = Substantially all 2 = Substantial majority 0 = Active	
		No general partner or any principal may close or act as general partner for any fund with substantially equivalent investment objectives and policies until after the investment period ends, or the fund is invested, expended, committed or reserved for investments and expenses.	3	5 = Restriction covers all funds 3 = Restriction covers funds with substantially equivalent investment objectives and policies	
		The general partner will not invest in opportunities that are appropriate for the fund through other investment vehicles unless such investment is made on a pro-rata basis under pre-disclosed co-investment agreements established prior to the close of the fund.	3	5 = Pro-rata and under pre-disclosed co-investment agreement 3 = Pro-rata only 0 = Neither pro-rata nor under pre-disclosed co-investment agreement	
		Any fees generated by an affiliate of the GP, such as an advisory or in-house consultancy, whether charged to the fund or an underlying portfolio company, will be reviewed and approved by a majority of the LPAC.	No	All or nothing.	
Governance				78.04	
	Fiduciary Duty			28.64	
		No provisions exist that allow the general partner to reduce all fiduciary duties to the fullest extent allowed by law.	Yes	All or nothing.	
		No provisions exist that allow general partner to use its sole discretion and weigh its own self-interest against the interest of the fund. No GP should clear its own conflicts.	Yes	All or nothing.	
		No provisions exist where limited partners acknowledge and waive broad category of conflicts or affiliated transactions.	Yes	All or nothing.	
		General partner is required to present all conflicts of which it is aware of to the Limited Partner Advisory Committee for review.	3	5 = All conflicts presented. 1 = Only material conflicts presented.	
		Limited Partner Advisory Committee reviews and approves all affiliated and/or non-arm's-length transactions.	1	5 = Review and approval of all affiliated transactions 3 = Review and approval of all affiliated transactions over a certain threshold 1 = Review and approval only after aggregate threshold passed	
		A majority of LPs will be able to remove the GP or terminate the fund for cause.	2	3 = By majority vote 1 = By supermajority vote	
		Conditions precedent and other removal mechanisms are constructed so that LPs can act before there is irreparable damage to their interests.	3	5 = Removal upon indictment; no cure period or termination of bad actor as cure 3 = Removal upon preliminary determination of cause; no cure period or termination of bad actor as cure 1 = Cure period or termination of bad actor as cure	

	To the extent that an all-partner clawback is appropriate in order for the fund to indemnify the GP, this should be limited to a reasonable proportion of the committed capital but in no case more than 25% and limited to a reasonable period.	3	5 = Indemnity giveback expires 2 years after distribution and limited to 25% of commitment 3 = Expires 3 years after distribution and/or limit up to 33% of commitment 0 = Limit higher than 33% or no limit or longer expiration period.
	There are no provisions that allow general partner and its affiliates to be excused in advance or indemnified for conduct constituting a material breach of the partnership agreement, breach of fiduciary duties, or other "for cause" events.	3	5 = No indemnification for material breach of PS agreement, breach of fiduciary duty or other "for cause" events (w/ no MAE qualifier) 3 = No indemnification for material breach of PS agreement (w/ no MAE qualifier) or no indemnification for breach of fiduciary duty (w/ no MAE qualifier) 1 = No indemnification for material breach of PS agreement or breach of fiduciary duty resulting in material adverse effect
	Investment Strategy		6
	The investment purpose clause clearly and narrowly outlines the investment strategy. Any changes or modifications to investment strategy will be disclosed and approved by a supermajority in interest of the LPs.	Yes 3	All or nothing. 5 = Full compliance with standard 3 = Changes approved by LPAC 1 = Any term under the LPA may be amended by majority vote 0 = Strategy shift is possible without requiring an LP vote for an amendment
	The general partner recognizes the importance of time diversification during the stated investment period to avoid over-concentration in short time periods by having limitations on the amount of capital that can be called on an annual basis from limited partners. Funds will have appropriate limitations on investment and industry concentration (excluding sector-focused funds).	Yes	All or nothing.
	Explicit limitations or restrictions are placed on investments in debt instruments, publicly traded securities, and pooled investment vehicles.	Yes	All or nothing.
	The GP will accommodate a LP's exclusion policy, which may proscribe the use of its capital in certain sectors and/or jurisdictions. However, consideration of increased concentration effects on remaining LPs and transparency of process and policies must be requisite in the event of a non-ratable allocation.	1 1	5 = Full compliance with standard 3 = Some limitations/restrictions 1 = Only one limitation/restriction 5 = LPA has an excuse provision and limit on additional capital from non-excused LPs to protect against overconcentration 3 = Excuse provision with no limit to protect against overconcentration
	Changes to the Fund		6
	Any amendment to the limited partnership agreement requires the approval of a majority in interest of the limited partners and in some cases a supermajority. Amendments that negatively affect a particular LP require that LP's consent.	2 Yes	3 = Supermajority approval 1 = Majority approval All or nothing.
	Stronger No-Fault Rights and Withdrawal Rights		12
	Suspension of commitment period	3	5 = Suspension by majority vote of limited partners 3 = Suspension by two thirds of limited partners 0 = No suspension by vote of limited partners
	Termination of commitment period	3	5 = Termination by majority vote of limited partners 3 = Termination by two thirds of limited partners 0 = No termination by vote of limited partners
	Removal of the general partner	3	5 = Removal by 66 2/3% of limited partners 3 = Removal by 75% or more 0 = No removal by vote of limited partners
	Dissolution of the Fund	3	5 = Dissolution by 66 2/3% of limited partners 3 = Dissolution by 75% or more 0 = No dissolution by vote of limited partners
	Independent Auditor and Independent Fund Counsel		12
	Limited partners will be notified of any change in the independent external auditor of the fund.	No	All or nothing.
	The auditor will present their views on valuations and other relevant matters annually to the LPAC and be available to answer questions at the annual meeting of the fund. A list of the members of the LPAC should be provided to the auditors.	Yes	All or nothing.
	The auditor will review the capital accounts with specific attention to management fees, other partnership expenses, and carried interest calculations to provided independent verification of distributions to the GP and LPs.	Yes	All or nothing.
	When considering important matters of fund governance or other matters where the GP's interests are entirely aligned with the LP's, a reasonable minority of the LPAC may engage independent counsel at the fund's expense.	Yes	All or nothing.
	Independent auditors can be engaged on behalf of the fund and alert the LPAC of any known conflicts of interest.	Yes	All or nothing.
	Team		14.4
	Automatic suspension of investment period will become permanent unless two-thirds of LPs vote to reinstate within 180 days of when a key-man event is triggered or for cause event occurs (e.g. fraud, material breach of fiduciary duties, material breach of agreement, bad faith, gross negligence).	4	5 = Fully compliant 2 = Automatic suspension by key-man, but cause not included

	LPs will be notified of any changes to personnel and immediately notified when key-man provisions are tripped.	Yes	All or nothing.	
	Changes to key-man provisions are to be approved by a majority of the LPAC or LPs.	5	5 = Approval by LPs 3 = Approval by LPAC	
	Limited Partner Advisory Committee		0	
	LPAC reviews and approves the methodology used for portfolio company valuations (and in some cases, the valuations themselves).	0	3 = Valuation methodology 1 = Valuation	
Total			163.26	