LAWDRAGON INSIGHTS

[PRIVATE FUNDS]

DEBEVOISE & PLIMPTON

"You go to a leading funds group like Debevoise, and not only do you get what's current, but what terms have evolved — you can contextualize your thinking about what terms to go into the market with and that's a critical thing."

Summary of firm structure:

Debevoise & Plimpton is an international law firm with its roots in New York. Founded in 1931, Debevoise now has eight offices in the U.S., Europe and Asia and around 650 attorneys.

Size of fund practice globally – numbers of partners and associates who spend 50% or more of their time on fund formation:

New York: 7 partners (Erica Berthou, Jennifer Burleigh, Sherri Caplan, Michael Harrell, Jordan Murray, David Schwartz, Rebecca Silberstein), 1 of counsel (Woodrow Campbell), 6 counsel (Jane Engelhardt, Andrew Goldberg, Timothy Long, Gary Murphy, Richard Robinson, Katrina Rowe), 30 associates

Hong Kong: 1 partner (Andrew Ostrognai), 1 international counsel (Gavin Anderson), 3 associates

London: 2 partners (Geoffrey Kittredge, Anthony McWhirter), 1 of counsel (Marwan Al-Turki), 2 international counsel (Sally Gibson, Matthew Griffin), 7 associates

Washington, D.C.: 1 partner (Kenneth Berman), 1 associate

Levels of associates:

The private equity funds practice has associates at all levels, from those fresh from law school to very seasoned senior associates with years of funds experience. Associates typically join the practice full time after their second year at the firm, after having spent a 12-to-18-month rotation working in the corporate practice.

Diversity statistics:

GENDER	
Partners/Counsel/ of Counsel	7 out of 21 are women = 33%

MINORITY	
Partners/Counsel/ of Counsel	4 out of 21 = 19%

OPENLY LGBT	
Partners/Counsel/ of Counsel	2 out of 21 = 9.5%

Ancillary practice support in key locations:

Tax: Hong Kong – 1 international counsel (John Anderson), 1 associate

London – 2 partners (Matthew Saronson, Richard Ward), 1 international counsel (Cecile Beurrier), 3 associates

New York – 5 partners (Peter Furci, Adele Karig, Vadim Mahmoudov, David Schnabel, Peter Schuur), 3 counsel (Pamela Boorman, Yehuda Halpert, Rafael Kariyev), 5 associates

ERISA: New York – 2 partners (Lawrence Cagney, Jonathan Lewis), 1 counsel (Charles Wachsstock), 2 associates

Regulatory: Washington, D.C. – 3 partners (Kenneth Berman, Satish Kini, Robert Kaplan), 3 associates

London – 1 partner (Anthony McWhirter), 1 international counsel (Sally Gibson), 1 associate

New York – 1 partner (Michael Harrell), 1 associate

Key relationship clients:

Carlyle, CD&R, EIG, HarbourVest, KKR, Morgan Stanley, Oaktree, Providence

Recent publishable mandates:

Global Infrastructure Partners II, an $8.25 billion global infrastructure fund.

Providence Equity Partners VII, a $5.1 billion global media, entertainment and communications fund.

Oaktree Opportunities Fund IX, a $4.7 billion global distressed debt fund.

HarbourVest Partners IX, a $2.7 billion investment program

Turnover rate – notable departures and hires:

Andrew Goldberg, previously Of Counsel with Gibson Dunn, has recently rejoined Debevoise's funds practice in a counsel position.

Asset classes worked on:

Covers the full range of funds and separate accounts, including buyouts, debt (senior and mezzanine), distressed (debt and equity), emerging markets, energy/power, infrastructure, funds of funds, venture capital, hedge, real estate, secondaries, other (including sector funds focusing on healthcare, media/communications, technology and patents/royalties)

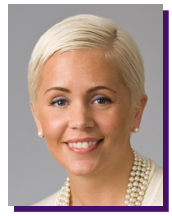
The engine of Debevoise's private funds practice is in New York, and from there, Erica Berthou coordinates a globally integrated team that has resources in London, Washington, D.C. and Hong Kong. The firm fields over 50 lawyers in the fund formation arena, acting for fund sponsors and also investors. The group has one of the deepest associate benches in the sector, with a uniformity of quality that enables the group to rebuff the accusation of inconsistency often leveled at large teams.

The firm is also notable for its trailblazing track record in diversity with more female partners than any other funds practice globally.

In particular, sources pinpoint the firm's strength in nurturing talent and bringing them on to assume increasing responsibility for key clients. The team has a strong roster of talented younger partners, such as Erica Berthou and Jordan Murray. Debevoise's select lockstep compensation is seen as an advantage by many fund managers who cite the experience of working with partners with great project management skills who are willing to share the work around to the right experts to make sure the transaction is handled correctly. And when you drill down beyond the partners, clients find *"you have the sense of a big machine behind the partners,"* as one said.

In addition, although the numbers are heaviest in New York, in-house counsel place the Debevoise team among an elite group of firms that can offer coverage in the UK, the U.S. and Asia. The group is among the counsel of choice for the most sophisticated fund formations across all major asset classes, and the team can count firms such as Oaktree Capital Management, KKR and Carlyle as clients. Debevoise also has a notable profile in emerging markets – with seasoned hands in Hong Kong, and a conspicuous penchant for fundraisings in Latin America – uncharted territory for many managers in terms of raising and deploying capital in both a pan-regional format and country-specific funds.

In summary, in-house counsel have found the group's global offering "*seamless,*" and when added to the firm's on-the-button, user-friendly and substantial tax function, Debevoise is firing on all cylinders in the private funds space.



[ERICA BERTHOU]

PARTNER – NEW YORK

"Erica is a force of nature. In baseball they talk about the five-tool athlete and she's the five-tool athlete – all the skills in abundance that it takes to be a leading private equity fund formation lawyer."

Grasping the reins in day-to-day management of Debevoise's global funds practice is Erica Berthou. One of the most common adjectives applied to her is that she is *"dynamic."* Clients marvel at her *"ultra-ultra responsiveness."* One in-house fund lawyer elaborates: *"She'll answer you within 30 seconds of an email, even if it's just to say 'I got your e-mail.' As an in-house lawyer, you always worry if someone hasn't answered you, then they're not dealing with it. So you always feel like you have her attention, she's all over it, she understands it, and gives you a commercial view – she wants to get the deal done, wants to get the job done."* This commerciality is a common theme among fund lawyers who work with her, with one detailing her *"strong feel for the all the issues in a transaction and making sure that we get the right advice for each piece."*

Berthou has handled a range of mandates for some of the world's leading fund managers across a range of asset classes. She has developed a specialty in Latin American investing, an increasing target for managers and a source of capital.

MANDATES

- Carlyle in raising nearly $20 billion in various emerging markets and Europe, including Carlyle Peru Fund, a $308 million fund, and Carlyle South America Buyout Fund, a $1 billion fund
- Global Infrastructure Partners II, an $8.25 billion global infrastructure fund
- Oaktree Opportunities Fund IX, a $4.7 billion global distressed debt fund
- EQT Credit Fund II, a $1 billion Europe credit opportunities fund

[JENNIFER BURLEIGH]

PARTNER – NEW YORK

"Sophisticated structuring advice on emerging market funds"

Jennifer Burleigh is known for her expertise in Latin America. Her work in emerging markets has included supporting managers from emergent regions in accessing international markets. Her clients include the likes of Gávea Investimentos and Vinci Partners, and she advises across a range of strategies, including energy/infrastructure, buyout, mezzanine, distressed debt, real estate and equity funds. Burleigh is notable for the breadth of her practice. She also works in the field of asset manager spin-outs and the establishment of new investment firms, as well as in strategic investments in private investment firms, on behalf of sponsors and institutional buyers. In addition, she is experienced in the formation of *"permanent capital"* and evergreen investment vehicles, employee investment programs and strategic joint ventures.

MANDATES

- EIG Energy Fund XVI, a $6 billion energy and energy-related infrastructure fund
- Odyssey Investment Partners Fund V, a $2 billion U.S. buyout fund

[SHERRI CAPLAN]

PARTNER – NEW YORK

In addition to her work on behalf of sponsors, Sherri Caplan has particular expertise in assisting first-time funds.

Her skillset spans a full complement of strategies, including buyout, mezzanine, venture capital, infrastructure and real estate funds. She is known for her track record in infrastructure and real estate funds – currently two of the hottest asset classes in the industry.

MANDATES

- Alinda Infrastructure Fund II, a $4 billion infrastructure fund
- TPF II (Tenaska), a $2.4 billion energy fund
- Tishman Speyer Brazil Fund III, a $450 million Brazil real estate fund

[MICHAEL HARRELL]

PARTNER – NEW YORK

"He's very, very good. We had a problem, I went to Mike, he said 'I will fix it,' and he did."

Michael Harrell, having led the growth of the Debevoise funds practice for more than 15 years, now co-chairs Debevoise's broader private equity group. Ranked in the top tier of fund formation lawyers every year since rankings were first published more than a decade ago, he is *"one of the godfathers of the industry"*. He is universally popular among general counsel at the top of the fund formation food chain who appreciate his long experience in the field. *"He was there at the creation,"* explained one interviewee, who went on to add that *"he's just got depth of knowledge – both of the particulars and also the history, that's just really not comparable."* Conscious of the succession planning for the group, Harrell has handed some of his key clients off to younger talent. However, he is still active on fundraising and is currently working on a number of funds both for new managers and new clients for the firm. He also is extremely keyed into regulatory developments and advises the private equity industry's U.S. trade association, The Private Equity Growth Capital Council, on global legal developments affecting the private equity industry.

[JORDAN MURRAY]

PARTNER – NEW YORK

"An extremely accomplished negotiator, technician and savvy deal guy."

Jordan Murray has acted for an impressive stable of clients including Clayton, Dubilier & Rice, D.E. Shaw, Providence Equity Partners and Third Point, among many others. He appears on behalf of sponsors and institutional investors in open- and closed-ended private equity funds, hedge funds, co-investment vehicles and separately managed accounts. In addition, he guides clients through strategic minority investments in private firms and is experienced in restructuring private investment firms.

MANDATES

- Third Point Hellenic Recovery Fund, a $750 million Greece-focused buyout fund
- Providence Equity Partners in raising over $24 billion for multiple global buyout and credit opportunities funds and separate accounts, including Providence Equity Partners VII, a $5.1 billion global media, entertainment and communications fund
- Clayton, Dubilier & Rice in raising over $16 billion for multiple global buyout funds, including Clayton, Dubilier & Rice Fund IX, a $6 billion global buyout fund

[DAVID SCHWARTZ]
PARTNER – NEW YORK

"A truly standout track record in the secondaries space."

David Schwartz is a seasoned and senior member of the group who acts for both sponsors and investors in fund formation, as well as in the arena of secondary transactions. He has been at the forefront of many of HarbourVest's mandates and often works closely with colleagues in the buyout space on structured secondary transactions. His expertise in investor side and secondary work means that he is often a savvy presence on the other side of the table from traditional fund sponsors.

MANDATES

- Dover Street VIII (HarbourVest), a $3.6 billion global secondaries fund
- Capital International Private Equity Fund VI, a $3 billion global emerging markets fund

[REBECCA SILBERSTEIN]
PARTNER – NEW YORK

Commercially savvy and knowledgeable

Rebecca Silberstein's work for clients such as KKR and Morgan Stanley has caught the eye of the market in recent years. She acts for sponsors in the formation of a broad variety of funds strategies, in addition to advising on the acquisitions and dispositions of interests in private equity firms, spin-outs of management teams and the establishment of new firms. She also assists clients with carry plans and employee investment programs.

MANDATES

- Kelso Investment Associates VIII, a $5.1 billion U.S. buyout fund
- KKR Energy Income and Growth Fund I, a $2 billion energy and natural resources fund
- Trident VI, a $4.25 billion global financial services buyout fund

[KENNETH BERMAN]
PARTNER – WASHINGTON, D.C.

Kenneth Berman focuses his practice on providing regulatory and compliance advice to financial services firms, particularly investment advisers and sponsors of mutual funds, private equity funds and other pooled investment vehicles. He also counsels mutual fund independent directors and advises operating companies concerning status issues they may face under the Investment Company Act of 1940. Clients note that he is *"an impressive lawyer"* and offers "*invaluable support throughout the decision-making process.*"

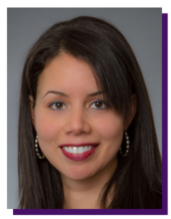
[SATISH KINI]
PARTNER – WASHINGTON, D.C.

Satish Kini wears many hats. He co-chairs the firm's banking group, in addition to sitting in the corporate and financial institutions teams. He is active in advising financial institutions on regulatory and banking issues, as well as acting for firms and industry trade associations in connection with regulatory reform issues. It is in this area that he has been spotted by funds counsel. His representations have included advising banks on Dodd-Frank implementation, and he has appeared before U.S. federal banking regulators, as well as the SEC and U.S. Treasury Department on behalf of clients wishing to participate in the policymaking process.

MANDATES

- Financial industry groups including the American Council of Life Insurers and the Financial Services Roundtable, in connection with the rulemaking process under Dodd-Frank

[KATRINA ROWE]
COUNSEL – NEW YORK



"A fantastic asset"

At the up-and-coming end of the New York team, Katrina Rowe is acknowledged to be *"adept at dealing with LPs and knows how to say no in a nice way"* by her loyal client following. She also acts for investors, and her fundraising activities encompass buyout, venture capital, mezzanine and funds of funds matters.

MANDATES

- Oaktree Opportunities Fund IX, a $4.7 billion global distressed debt fund

[MATTHEW HOWARD]

ASSOCIATE – NEW YORK

"If you speak to him, he gives you counsel. He's not half-paced."

When you're advised by Matthew Howard, *"you feel like you're in safe hands,"* we were told. On top of that, he has a knack of putting clients at their ease: *"he's got a nice, easy flow about him: he's easily reachable, friendly, conversational, he's got a personality – you're not talking to a brick wall."* He acts for sponsors of closed-ended funds targeting markets such as Europe, South America, Africa and Asia, on top of representing U.S. funds.

MANDATES

- Odyssey Investment Partners Fund V, a $2 billion U.S. buyout fund

[PETER SCHUUR]

PARTNER – NEW YORK

Practical, proactive approach to US and UK tax systems.

Before joining the firm's New York group, tax partner Peter Schuur spent eight years in Debevoise's London office. His experience there led one fund counsel to describe him as *"the only guy I know that really understands UK and U.S. tax issues."* Another in-house lawyer elaborated on this facet: *"He really gets both systems – neither of which are designed to work together."* Coupled with this understanding, fund counsel really like this lawyer's proactive approach to problem solving - even before the problem has presented itself. One satisfied client told Insights that this thinking ahead really sets this lawyer apart for them, *"Peter told us: 'there's draft legislation in U.S. Congress about carry so I'm going to set up your structure this way, which should that ever pass will deal with it that way' — he's really at the cutting edge of this stuff."*

Schuur's recent mandates on the fund structuring side include significant work in Latin America, one of the most interesting new markets for fund managers; here he represented Carlyle in structuring funds focused in the region.

MANDATES

- EQT Credit Fund II, an $1.16 billion Europe credit opportunities fund
- Carlyle Peru Fund, a $308 million Peru buyout/venture fund
- Global Infrastructure Partners II, an $8.25 billion global infrastructure fund
- Carlyle South America Buyout Fund, a $1 billion South America buyout fund

[PETER FURCI]|

PARTNER – NEW YORK

"I like to say that Peter's not just the best tax lawyer I know, he's the best lawyer I know."

Peter Furci is based in Debevoise's New York office, but as a member of the Latin America group, his practice stretches to private funds tax advice in that region as well. In addition to his emerging markets work, he provides tax support in the hedge, mezzanine, infrastructure, real estate and distressed debt spaces. Fund sponsors explained to us that they find him *"absolutely phenomenal,"* because he is *"very strong technically, incredibly client-responsive and personable."*

MANDATES

- Alinda Infrastructure Fund II, a $4 billion infrastructure fund
- Oaktree Opportunities Fund IX, a $4.7 billion global distressed debt fund

[JONATHAN ADLER]

ASSOCIATE – NEW YORK

Jonathan Adler is earmarked by clients as *"a very talented guy."* He acts for sponsors in a number of emerging markets such as Africa, India and South America, as well as U.S. and European-based funds, and his experience has included buyout, growth capital, infrastructure, energy and credit funds.

[ANDREW AHERN]

ASSOCIATE – NEW YORK

Andrew Ahern's practice focuses on advising sponsors of private investment funds, including buyout, energy and infrastructure and credit opportunities private equity funds and hedge funds.

[RICHARD ROBINSON]

COUNSEL – NEW YORK

Richard Robinson advises sponsors of private investment funds, including buyout, infrastructure, real estate, emerging markets and mezzanine funds.

[GEOFFREY KITTREDGE]

PARTNER – LONDON

"He knows the European approach to things but is able to bring the American lawyer-type business sensibility."

Geoffrey Kittredge has been based in the London office since 2002, where he chairs Debevoise's European private equity funds operation. He's an experienced and *"phenomenal"* hand, say sponsors, who hail from a client list from the buyout, mezzanine, real estate, secondaries, and funds of funds spaces. He is also a member of the EMPEA Legal & Regulatory Council.

MANDATES

- Baring Vostok Private Equity Fund V, a $1.5 billion Russia/CIS buyout fund
- Park Square Capital Partners II, an $1.17 billion Europe mezzanine fund

[SALLY GIBSON]

INTERNATIONAL COUNSEL – LONDON

"Very effective, very responsive."

Sally Gibson represents fund sponsors on private equity funds, alongside hedge and other investment funds, from the London office. Clients report that she has *"really absorbed herself"* in this field, and the breadth of her practice extends to regulatory work alongside her fund formation advice, meaning that *"she knows the whole thing."*

MANDATES

- EQT Credit Fund II, an $1.16 billion Europe credit opportunities fund

[RICHARD WARD]

PARTNER – LONDON

"Very good at turning complicated tax issues into short sentences."

Richard Ward chairs the firm's UK tax practice, which fields a strong offering in advice on fund formation tax issues. Fund counsel were perfectly clear on what makes Richard stand out: *"He'll give you good, commercial tax advice."* The user-friendly service he provides to clients is greatly valued, with one describing his style thus: *"He often wants to pick up the phone rather than to email you – to understand a point, but also to be able to give you more freestyle tax advice."*

MANDATES

- Global Infrastructure Partners II, an $8.25 billion global infrastructure fund
- Park Square Capital Partners II, an $1.17 billion Europe mezzanine fund

[ANDREW OSTROGNAI]

PARTNER – HONG KONG

"Very well suited to emerging managers that may not be as familiar with the rules of the road."

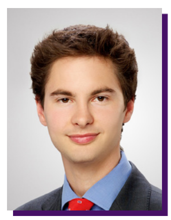
Andrew Ostrognai chairs the Debevoise Asia private equity funds practice from Hong Kong, and is something of a figurehead in this market, spearheading a team that is very much a go-to for general partners operating in the region. He serves as a member of the Advisory Council of the Emerging Markets Private Equity Association, and his fund formation experience is broad, encompassing large pan-Asian buyout funds, smaller focused sector and country-specific funds, RMB-denominated funds and separate account programs. Interviewees highlighted his *"avuncular"* style and concern with *"commercial – not just the legal."* His client list is an eye-watering mix of some of the emerging markets biggest sponsors, including the likes of Hony Capital and CDH Investments.

MANDATES

- CDH Fund V, a $2.6 billion China growth capital fund
- Hony Capital Fund V, a $2.4 billion China growth capital fund

[GAVIN ANDERSON]

INTERNATIONAL COUNSEL – HONG KONG



"Extremely bright, extremely responsive, very intelligent: he just gets it."

Gavin Anderson enjoys much visibility on the ground in fund formation work for sponsors. *"He's more qualified than me,"* one interviewee said, and perhaps this goes some way to explain his involvement in some of Debevoise's flagship representations. His clients include CDH Investments and Baring Private Equity Asia.

MANDATES

- CDH Fund V, a $2.6 billion China growth capital fund

[INSIGHTS] Q&A

BY CATHERINE MCGREGOR

ERICA BERTHOU
DEBEVOISE & PLIMPTON (NEW YORK)

Erica Berthou is rapidly rising to the top echelons of fund lawyers. A member of the Debevoise & Plimpton's private equity funds and investment management groups, she specializes in advising sponsors of open- and closed-ended private investment funds, co-investment funds and separately managed accounts in U.S., European and emerging markets, with a particular expertise in Latin American investing. She represents a range of leading fund managers including Brookfield Asset Management, The Carlyle Group, Oaktree Capital Management and Global Infrastructure Partners. She sat down and spoke to Insights about the opportunities she sees in Latin America and fundraising approaches for managers in that region.

JANUARY 2014

Lawdragon: There has been recent publicity about the increase in fundraising in Latin America. What is it that is making the region so attractive for managers now compared to other markets?

Erica Berthou: The first bucket of drivers is really the rapid growth of the economies, which is creating investment opportunities.

In most countries there is a growing middle-class with improved purchasing power. And, in Latin America, the consumer industry is one of the industries of interest. The region also has significant natural resources, so you see many funds focused on agriculture, timber, oil and gas. At the same time, Latin America generally has more mature corporate governance structures, a quite developed legal framework and provides for more political stability compared to certain other emerging markets.

The second bucket of drivers is that private-equity fund investment in Latin America is also starting to yield benchmark statistics that compare favorably to other emerging markets and certain developed markets, further fuelling investor interest.

LD: Within Latin America, what are the most attractive markets for investment and why is that?

EB: Most Latin America funds raised to date focus on Brazil. This is primarily driven by Brazil's rapidly growing economy combined with a relatively stable and developed market. However, fund managers and investors, for example, are also increasingly viewing Colombia, Mexico and Peru as attractive. Even more so as of late, in part due to the price-levels in Brazil and the many Brazil funds already raised. We have even seen a Peru-only fund being raised by an international fund sponsor. That being said, some investors will prefer pan-Latin America funds focusing on more than one or a couple of Latin American countries so as to diversify the risk posed by investing in a small number of emerging countries.

LD: Are there particular types of funds or asset classes that you see investors being more attracted to than others?

EB: Because of the nature of this market, where growth and natural resources are among the primary drivers for investment, you will find that growth funds and various resource funds are at the top of investors' lists. We also see a number of mid-market buyout funds attract interest. There certainly are some larger buyout funds, but there are a number of funds by prominent sponsors in that space and it is starting to be a crowded space. There's a lot of dry investment powder in the region and in Brazil, in particular, driving prices up in the buyout space. There is also a real estate fund and infrastructure fund focus in the region. There are a number of fundraisings in that space right now.

LD: Tell me a bit more about the impact of dry investment powder in the region and how that is affecting things?

EB: The high levels of dry powder in the region may actually stall Latin America fundraising activities. Investors will want to see that fund managers can put the capital to work before committing more capital. Also, a number of billion-dollar funds were raised a few years ago and they are in the process of being deployed. If you were to generalize, I think the size of the funds currently raised generally is smaller. All in all this may lead to overall lower

fundraising numbers for a while, even though investors are intending to increase their investment allocations to the region.

LD: Are there structuring issues that managers looking to Latin America for the first time have to be aware of, particularly on a jurisdiction-to-jurisdiction basis? Is there a difference between international Limited Partners versus domestic LPs?

EB: There are a number of special considerations to bear in mind when raising capital from Latin American investors. Much of the capital comes from Colombian, Chilean and Peruvian pension plans. You will have to comply with the local marketing rules irrespective of whether the fund will invest in or outside Latin America.

Peru creates a lot of challenges, but is an interesting jurisdiction because of increased allocations from Peruvian pension plans to private equity. Each fund needs to be registered with the regulator and the regulatory framework is also undergoing significant changes (expected to come into force late this year); this is a lengthy process that can take several months. The fund manager needs to demonstrate experience, that it has a certain amount of assets under management, agree to certain investment limitations relating to borrowing (short-term only) and derivatives (only for hedging purposes) and agree to limitations on in-kind distributions (which are not permitted at all). Several fund managers have now registered funds in Peru so the good news is it is not entirely unchartered territory.

Chilean pension funds need to invest in international PE funds through locally registered feeder funds, which need to be marketed by a local intermediary and managed by a local manager. Customary terms such as recycling, LP payback provisions, default and transfer restrictions impose challenges, but all of them are manageable.

Colombia is a more straightforward jurisdiction than Peru and Chile. If appropriately managed, no local registration or intermediary should be required. There are some qualification requirements imposed on the fund manager, but experienced managers should not have a problem meeting those.

LD: Is there any standard approach to private funds in Latin America?

EB: There is no one-size-fits-all fund structure for all of Latin America. But the good news is that at this point a number of developed structures exist. A fund manager will need to look at what country or countries it will invest in, what type of assets the fund will target and from which investors capital will be raised to arrive at the most appropriate structure.

> "THERE IS NO ONE-SIZE-FITS-ALL FUND STRUCTURE FOR ALL OF LATIN AMERICA. BUT THE GOOD NEWS IS THAT AT THIS POINT A NUMBER OF DEVELOPED STRUCTURES EXIST. A FUND MANAGER WILL NEED TO LOOK AT WHAT COUNTRY OR COUNTRIES IT WILL INVEST IN, WHAT TYPE OF ASSETS THE FUND WILL TARGET AND FROM WHICH INVESTORS CAPITAL WILL BE RAISED TO ARRIVE AT THE MOST APPROPRIATE STRUCTURE."
> —ERICA BERTHOU

In Brazil, the favorable tax treatment afforded to non-Brazilian PE investors in so called "FIPs" (Fund for Investment in Equity Participations) lead most fund managers to incorporate a FIP in their fund structure. The FIP is a regulated Brazilian vehicle particularly suited for private equity investments. There is often a complex layered fund structure imposed above the FIP, designed to address tax, regulatory and contractual considerations of the fund investors and the fund manager. This is an area in which international and local legal counsel need to work closely together to create bespoke fund structures.

However, equally important to the fund structure itself is also to pay attention to the below-the-fund acquisition structure. Various acquisition structures may be implemented on a deal-by-deal basis. Tax treaties between certain international countries and Latin America play a role here: Spain has a favorable tax treaty with Latin American countries, for example. At the end of the day, because there is no one-size-fits-all structure and because the legal, regulatory and tax landscape may well develop during the investment phase of a fund, it is crucial that the fund documentation provides for flexibility to cre-

PHOTO BY LAURA BARISONZI

ate alternative fund vehicles and acquisition vehicles throughout the life of the fund. Even a fund focused on a particular country typically would have the flexibility to invest some amount of its capital in other countries so you would need nimble structuring ability to cover also such situations.

LD: In regard to Brazil, what are the advantages and limitations of the FIP and the Fund for Investment in Emerging Companies (FMIEE) models?

EB: As mentioned previously, the FIP can create tax advantages for foreign investors and the FIP is a good vehicle for investment in stock of companies. However, it is not a favored vehicle for investment in real estate and debt because of FIP limitations imposed on those asset classes. Another limitation is that no more than 40 percent of FIP quotas can be owned by a single investor and its related entities so you will need a diversified investor pool and you typically would end up with more than one fund vehicle as a result. There are certain blacklisted jurisdictions that cannot be used to invest directly in a FIP, such as the Cayman Islands, if one is to take advantage of the favorable tax treatment.

Finally, it is important to bear in mind that the FIP is a regulated vehicle so it comes with some hair on it. The incorporation process is more cumbersome than what you would expect from a Delaware vehicle, for example, including from a timing perspective. The official governing document of the FIP is in Portuguese and publicly available on the regulator's website. A FIP also doesn't provide for limited liability for its investors. These are a few of the reasons why it rarely serves as the vehicle that foreign LPs invest directly in and why some structuring on top of the FIP is required.

LD: It's been said that Latin American investors, particularly Brazilian pension funds, have traditionally had more appetite for direct investment. Is this still the case or is the traditional LP model now taking hold more?

EB: It may be interesting to focus on Brazilian pension funds in this context. They have been uncomfortable with the traditional LP model, where LPs take a passive role in customary investment and exit decisions. They typically request representation on the sponsor's investment committee, which would be very, very rare in a traditional fund model. Local requirements also give them more governance rights in respect of fund expenses, fund manager removal provisions and conflicts of interest.

To address these special requirements and at the same retain customary fund terms with international fund investors, you can have a local vehicle for Brazilian pension funds and an international vehicle with other investors, each having different terms. That creates a fair number of conflicts issues from a fiduciary and investor relations perspective. As a result, international sponsors tend to view Brazilian pension money as hard to raise and get comfortable with. Ultimately this may foreclose the opportunity for Brazilian pension funds to invest in funds with the full array of premier fund managers. This market is currently undergoing development and certain Brazilian pension funds are starting to align their requests and expectations with those of the broader investment community.

LD: Environmental, Social and Governance (ESG) issues seem to play a large part in due diligence concerns for LPs in this market — can you discuss if and how that has affected any funds you have worked on?

EB: Based on my experience, fund investors generally are more focused on ESG issues compared to only a couple of years ago, although the focus on these issues is perhaps more pronounced in connection with emerging market activities.

One of the fundamental notions when you are talking about environmental, social and governance factors as part of private equity investment is the positive (or negative if you are on the wrong side) impact such factors may have on investment returns. This may range from good working conditions for factory personnel to efficient decision-making procedures in a company. Some of the things that we may take as a given in developed markets due to market practices and legal requirements are not as controlled in certain emerging markets. LPs will want to know that the fund managers are focused on this; they want to know that fund managers have ESG policies in place and that compliance is monitored in each step of the investment chain (diligence/acquisition, investment management and exit).

In some of the emerging markets funds we have worked on there are very developed ESG procedures and they become part of the contractual framework governing how the fund is managed. Governmental and supra-national investors can be helpful to fund managers in developing their procedures in this regard.

Ultimately, if there are teeth to the procedures, a fund manager would be required to work with portfolio company management to address any ESG concerns raised in connection with the portfolio company's activities. ■

[INSIGHTS] Q&A

BY CATHERINE MCGREGOR

JORDAN MURRAY
DEBEVOISE & PLIMPTON (NEW YORK)

Jordan Murray is among the elite Private Funds lawyers at Debevoise & Plimpton, where he practices with the private equity funds and investment management groups. He advises sponsors of, and institutional investors in, open- and closed-ended private investment funds, co-investment vehicles and separately managed accounts. He represents numerous private fund clients, including BGI; Clayton, Dubilier & Rice; GE Asset Management; Newport Global Advisors; Pharos Capital; and Providence Equity Partners. He spoke to Insights about current trends in private funds' use of separate accounts.

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Lawdragon: Let's start off with a sense of the evolution of separate accounts, essentially what they looked like when they first started versus how they're being used now and how their terms and structuring have changed?

Jordan Murray: I would think my experience dovetails with the market. There's really been an explosion in separate accounts over the past few years. Before that, what I had seen more of was investment management agreements, where managers were being paid a fee to advise clients on a discretionary or non-discretionary basis, but really the clients were the owners of the underlying assets and they were really management agreements.

What I see now as more prevalent in our industry is single-investor partnerships where our clients are typically the sponsors, although there are times we're on the investor side, as well. It almost looks like a blind-pool partnership, just like a typical private investment fund where the manager takes a capital commitment and there are certainly sometimes discrete investment restrictions, or parameters, in which the manager may go out and buy assets and manage them for the individual client.

In that sense it feels very much like a private equity fund that I would raise for a blind-pooled multi-investor fund. But, the differences are: they are bespoke, in so many ways, and the investment restrictions may be much tighter, or dissimilar, and you're really getting into the weeds with your individual client investor, as to what they're looking for.

It goes down to controls, so that the investor very often has the ability to shut off all their investments at any time. There are a lot more governance restrictions where you're not talking so much about maybe key-man protections and the like, where the investors as a whole have the ability to make certain decisions. In the partnership context, the sponsor will continue to manage out the assets; in the investment-management agreement context, the client walks away with the assets and the music stops on fees and rights.

LD: So any portfolio companies would shift completely to ownership by the investor?

JM: It would. It is exceedingly rare to see those arrangements on the buyout, growth equity, or equity investment front, where it's private investments. You'd see that with hedge-fund firms, or other liquid-type strategies. You may even see it in some credit strategies on the private side where the client could walk away actually having ownership over the assets.

I see fewer separate accounts on the equity side. And even in the real estate space, it is typical that new investments stop at the manager who manages out those investments, and there may be rules about how that happens, and a significant scale-down of fees if that happens. But as I said, it's exceedingly rare that the investor then has control of the assets.

LD: You mentioned that separate accounts are becoming more popular. Why do you think that is?

JM: It's up and down and for a number of reasons why they became more prevalent. Maybe it makes sense to talk about the different kinds of separate accounts out there. Some, for the large-asset managers, it's almost like a large fund-of-funds, where you saw Texas Teachers [the Teacher Retirement System of Texas] devoting $3 billion to the KKRs of the world, or the State of New Jersey, where really they're making enormous commitments to multi-product managers.

One is the large, extremely large - at least the examples in the press are billions - more of a fund-of-fund type approach for the largest of managers, where the account is investing either in, or alongside, a number of this large sponsor's funds. These funds typically come with lower fees, sometimes netted carry across products, bespoke reporting and heightened governance rights.

The next is a separate account with a focused investment strategy, so maybe more limited than an existing fund, or as a hybrid of a sponsor's funds out there, or potentially a different investment strategy. It's just a new strategy. That could be a sponsor again wanted to create a track record, or saying, "I go out and source all these types of investments but I would never do something with less than a hundred billion [dollars] equity from a large buyout and I see all these growth opportunities, I'd love to get in there." Those types of separate accounts may or may not come with all those goodies that I went through, economics, certainly not the netted carry; it's not about that, but possibly governance and greater transparency or potentially just bespoke reporting.

The next is sort of a spill-over type separate account, and this is where you astutely pointed out that look, there may be real protections for investors, but this gives me the ability to find a new investor and say, look, "You like what we're doing?" It's sort of a courtship. I can bring you into some of my existing funds' deals, but only if you live within the construct of my existing partnership agreement, so it frequently means you'll participate in the large deals where the fund has gotten its full fill of equity. And I'll bring you in, like any other co-investor, and those may be discretionary or not.

The next type, is more of a one-off deal. Where the sponsor and investor find a deal together.

LD: So that's more like a co-invest?

JM: More like a co-invest, and it's a little bit like a pledge fund – you sign off. You analyze the deal, I either found it, or I'm managing it and that again frequently comes with a reduced management fee. In all of these, you have to think that certainly on this type of an arrangement, but even on some of the others, the fee may be based on invested capital. Not committed capital – it's a big difference for an investor.

The next may be the least common, but that sort of pledge fund arrangement where we say I'm allocating a quarter of a billion dollars to you, you find deals, you bring to me, I'll approve them, or not. I think that separate account has far less appeal to a sponsor.

That generally covers the universe. In examples two and three there's a number of different flavors of account that can fit in there. And we generally see them as being more prevalent on the credit side.

LD: Why are separate accounts becoming more popular?

JM: For the manager in the fund-of-fund type model, it's a huge boon because you've got $3 billion. For the investor they have a great amount of control, they largely come with reduced fees, and it's almost as if you're investing in the underlying funds, in or alongside, but with more beneficial terms. The beneficial terms largely are economic-related. It may mean that your investment in the equity fund, and the real estate fund and the debt fund are netted for carry purposes, so if one's up, one's down; you know, you'll receive less carry on the whole. It may mean that it's a lower management fee, it may mean that you have particular reporting requirements that you need done by your sponsor, and you'll get those in these types of funds.

Those really popped up, post-Lehman crisis, that was the 2009-2011 version, of state plans coming in, and flexing their muscle. I should step back and say the most frequent players in separate accounts that we see are the state plans and the sovereign wealth funds – the large, non-U.S. government funds; these days, largely Asian governments, but before that Middle Eastern. If you're a single product manager, it may be your first foot in the door with a non-U.S. sovereign and it may be between funds, so you may set up a wholly different type of animal where it's a separate account that's set up to co-invest with your main fund to attract these sort of large investors. In large deals, where the main fund gets its full fill - rather than going out to your own investors – and separate accounts are rife with investor-relations issues with other investors - you might set it up that this new separate account, let's say, with your sovereign wealth fund, new relationship, would get to participate in those deals. Sometimes reduced economics, sometimes not, the main benefit to the sponsor is that you create a relationship off-cycle, with this sovereign wealth fund.

LD: Say you have your traditional buyout fund with multiple investors, and you have a particular investment strategy for that that's already closed; you get your foot in the door with our sovereign wealth fund, you set your separate account up. Could you pursue the same investment strategies with that separate account?

PHOTO BY LAURA BARISONZI

JM: So much of being able to set up separate accounts and what happens after separate accounts depends on the terms of your existing agreements.

LD: It does seem if I was an investor in the first fund, I might be a bit upset.

JM: Exactly right and you may actually be protected. There are typically two protections. Let's call it the single-product firms' documents. One is that I can't raise a successor fund until I've used committed invested capital, typically 75 percent of the assets. So you'd have to be careful that this new separate account is not picked up by this successor fund.

There's also oftentimes a covenant that the manager will give all investment opportunities to this fund that you're invested in as the investor before anyone else, and it's why, with this flavor of separate account, it's really a spill-over vehicle. It means, if I'm doing a large deal, I would typically go off and find another partner for the deal, or I would go to my own limited partners and give them what they love – no-fee, no-carry co-invest – I have the separate account off on the side. And you're exactly right, investors are very, appropriately so keen on this issue and protect themselves.

Now, there are some firms, particularly the multi-product firms, where their partnership agreements say that they will allocate investment opportunities on a good faith basis. Their investment allocation policy - all of these sponsors are SEC-registrars now, so they all have policies on investment allocation - will dictate how they allocate those investment opportunities. It sometimes can be a little bit loosey-goose - they do it in good faith but also the market works itself out in the sense that you better do right by your investors if you have this product flexibility to allocate investments. Because if it turns out that you are allocating them away to others, your client base won't be there – your limited partner base won't be there for the next fund. But that's why, in my practice, I see separate accounts really booming in terms of, not the fund-to-fund, as in the Texas Teachers separate account, but in this example of the one-off separate account. I see them as being more prevalent in the credit space.

In the credit space, it seems like the mouths-to-feed issue is not as pressing, and with our credit managers or at least our managers where they have credit products, they're talking more and more with investors about separate accounts. And there it is oftentimes, again, off-cycle, where you've closed your credit fund. Or, the manager is speaking to large- or medium-sized investors that say "I like what you're doing, but I want different. I want only U.S., I want higher yield, I want to be in the mezzanine space." We see a little bit of those separate accounts participating in some, but not all, of an investment program of a main fund, if you will, or a mezzanine fund, whatever it may be. It's really those managers that seem to keep coming back and talking to us about separate accounts. It's also where the large investors, frankly, push on them for lower management fees.

LD: It seems to me that a lot of the traditional fund structures today are more like collections of side-letters rather than just the traditional Limited Partnership Agreement. How do all the side-letters impact if you then go on and do a separate account, given that you've got all these individual provisions with the investors in the main account?

JM: Side-letters have really taken on a life of their own in these funds. You could have your partnership agreement, that may be a 110-page document, but then you have 100- plus side-letters in these large funds. It's interesting and you spend a lot of time on side-letters and some of them are really about the individual investor's needs or comforts – reporting, business days, Chinese holidays, you know, small stuff that doesn't have an impact on other investors.

An important note about side-letters, you should take the position these partnership agreements allow you to

"YEAR OVER YEAR, INVESTORS BECOME FAR MORE INTELLIGENT ABOUT ISSUES THAT THEY MAY FACE AND CERTAINLY GOVERNANCE PROTECTIONS IS ONE OF THEM, WHEN THEY THINK ABOUT WHERE INVESTMENTS MAY BE ALLOCATED. PARTICULARLY AS THERE'S THIS GROUP OF VERY LARGE MANAGERS, THAT ARE MULTI-PRODUCT, AND ARE GROWING ASSETS UNDER MANAGEMENT AND HAVE SEPARATE ACCOUNTS."

—JORDAN MURRAY

enter into side-letters with investors so long as you're not impacting those investors' investment experience. So the side-letter cannot conflict with the partnership agreement, but it can change the deal as between the general partner, sponsor and that particular investor. There are some areas where side-letters sort of can start to feel a little bit more separate account - to the extent that an investor has a number of excuse rights, their investment experience may start to look different.

Historically these excuse rights have been about alcohol, pornography, and gambling, particularly in a fund that isn't looking at casinos, and so they have not had an impact on the fund. Every now and again, there are real excuse rights, that you may, if you are investor A, your portfolio at the end of the day may look different than investor B. In terms of side-letters and how they impact a sponsor's ability to raise separate accounts, sometimes side-letters

really tighten the sponsor's ability. Meaning an investor will say, I'm investing with you, but you cannot raise another vehicle that invests in this space. Or a typical provision is before you go out and close a separate account - even an investment-management agreement where you will be focusing on equity investments in buyout funds - you have to go to the advisory committee, you have to notify them which is a little prophylactic but in the eyes of the investors, at least, it gives them a little comfort that a sponsor wouldn't come unless they have a very good reason, or it's stepping into the cross hairs of our largest investors and most important investors - at least, most sponsors deem that advisory committee to be that group.

LD: Would they always have to go to the advisory committee for approval?

JM: No, it really depends, and it depends what you've agreed to. If you have a covenant that says I can't do this without advisory committee consent – it better not say in the side-letter without your consent, because a lot of these funds take this most-favored-nations process where every investor gets to picket. If you put that in your side-letter and then you have 50 other investors, who have that right to veto, then you absolutely can't do it, you just have to go to the advisory committee.

Frequently when there's not a restriction in the partnership agreement it's a notice requirement to go to the advisory committee. But I really think, in a buyout, leveraged, growth, equity-type fund, venture fund, it would be very hard to have a separate account that really takes investment opportunities away from the main fund, although investors are always quite worried about it.

LD: Are you seeing restrictions on separate accounts as being more of a standard issue in either partnership agreements, or in the various side-letters?

JM: It's more prevalent because investors are more aware of the issue, for sure. I don't think it's so much that investors have been burned by the issue. But it's a buzzword in the industry and investors know they're out there, Debevoise is having on three different continents, conferences about separate accounts, and so there's certainly a much greater awareness. Year over year, investors become far more intelligent about issues that they may face and certainly governance protections is one of them, when they think about where investments may be allocated. Particularly as there's this group of very large managers, that are multi-product, and are growing assets under management and have separate accounts, and investors are used to thinking through these issues. It's now unusual to have a situation like my client, Clayton Dubilier & Rice, who are raising fund nine now. And if they've sourced an investment, that's where the investment goes, in the current funds. There's less of that in sort of the big boy, or girl, space now. So yes, there's more attention paid to the issue

PHOTO BY WEI-CHUAN LIU/DREAMSTIME.COM

and there are good, healthy discussions to be had on it.

LD: How much are separate accounts being used in the same way as a co-investment strategy? Are you seeing big investors actually coming to particular managers and saying we're interested in getting into this space, let's do something together that's just you and me?

JM: I view a co-invest as a partner getting to invest, getting to make an individual investment decision on a deal. I'll get diligence on the company. I'll see the high-yield deck, whatever it may be, so it's not blind to me - I know what I'm investing in. Really they are one-off deals. I just actually did it in the real estate space, where a client of mine went out and found a new investor for them that was interested in picking up the mezzanine debt on a trophy building in New York City. That's really a co-invest, and there are economics surrounding that, and interestingly there really aren't termination provisions in the same way, because they aren't new investments - it was set up for one deal.

LD: So it's not a one-size fits all.

JM: No. It's quite bespoke and interesting, and the leverage dynamics change and, well, it very much depends what you're doing. But all of a sudden you're just negotiating with one investor over a product.

LD: What are the tax implications of a separate account? Are they the same as a traditional fund?

JM: In the investment management agreement context the answer is no. From the sponsor's point of view, my carried interest - the share of the profits that I take would typically be ordinary income. In the investment management agreement context , you would also be wary of deferred compensation type rules, which would mean you might be taking an incentive allocation based on both realized and unrealized value in the portfolio.

That is different than a private equity model where I take carry on realized dollars. The benefit to the partnership model is, at least in today's world, that carried interest gets the benefit of capital-gains treatment if the underlying character of the income warrants that. That's really the big difference from the manager's perspective. From the investor's perspective, the answer should be you should be tax neutral, but it's a material issue for the sponsor.

LD: Is it potentially a tax disadvantage to do a separate account?

JM: In an investment management agreement, where you're just advising, sure. It is more tax efficient and a tax advantage to have a partnership.

LD: But if you want to reel in a really big investor, potentially into a future fund it could be worth taking that hit.

JM: It could, but if the investment strategy is one where you're making private investments, they tend to lead you to a partnership structure regardless. I mean, there are other issues to think through as well, like custody of the assets and under the Advisor's Act what you have to do from the investor's perspective. Depending on who you are, there's this notion of when I terminate, what happens, are they mine? I think that's the largest issue from the investor's point of view. With the investment management agreement versus the partnership, I think in some ways there's an ease to the partnership structure, and you get audited financials for the entire partnership; it's not getting all the financials on a deal-by-deal basis. You may, in your separate account get bespoke reporting on the underlying portfolio oftentimes too.

LD: Is it pretty much a strategy that you're seeing confined to the very biggest managers with multi-platform strategies, that the big investors, like the Asia sovereign wealth funds and pension funds invest in or is it being used by smaller managers as well?

JM: It's splashier at the high end. And the press is there. But I think the answer is no. And we're seeing it with some investors, who maybe take issue with the status quo model and they want to get involved and buy an asset with a manager. So this example of buying up the mezzanine debt, sometime it's with a new investor into private equity who will typically come in one of two ways: They'll invest with the fund of funds, so they get a product portfolio, or they'll get a taste of an introduction to a manager through possibly a deal. Also sometimes it's with large investors but with small dollar amounts – it's that example of investor and sponsor meet and they get to create a relationship. Sometimes it's a sponsor who's starting a new strategy and they're building a track record, and they may do that with one of their long-term investors but it's giving them sort of a seed investment, allowing them to build a strategy. They may be a typical buyout, growth-equity shop who would like to start a long-short strategy, more of a liquid strategy, and they might seek a $25 million separate account, with preferred economics.

LD: To test it before it went to market?

JM: Yes, and be able to build a track record, and then market off of that track record. You certainly hear more about it at the larger end of the spectrum, both of sponsor and of investor. ■