

Family Office Insights

Introduction to Legal Issues and Due Diligence in Co-Investments

Like other institutional investors, family offices are struggling to produce acceptable returns on conventional investments in a low interest rate environment. Interest on fixed-return instruments is modest and equity markets appear highly valued. In this environment, private equity provides an opportunity for diversification and rare potential double digit returns. While the most common access to private equity is through portfolio funds, there is also a particularly lucrative opportunity for investors who can be agile in making commitments and taking advantage of co-investment opportunities with fund sponsors and their other clients. An added bonus is that participants in these co-investment opportunities normally avoid paying both the 2% management fee and the 20% carry that typically burden investments in private equity funds.

Taking the greatest advantage of these co-investment opportunities requires understanding the underlying investment and negotiating the most advantageous terms available among the pool of co-investors, including, among other things:

- The right to exit simultaneously and on the same terms with other co-investors
- Protections against sponsor fees and expenses
- Preemptive rights that allow maintaining the original investment participation
- Protections against sponsor conflicts of interest and abuse
- Tax planning protections
- Adequate rights to information about the investment
- "Most favored nation" rights with regard to other similarly situated investors
- Other protections depending on the size and circumstances of the investment

Since this is done in a "club" environment where there is more demand than supply, it is important to know what the market standard rights are and to request the appropriate rights without negatively impacting the negotiations/relationship with the investment's sponsor.

Although interests among co-investors are aligned in general terms, it is incumbent on an investor to conduct an appropriate level of independent due diligence and carefully review the financial, business and legal materials that the sponsor has available. It is also key to determine whether adequate due diligence has been conducted on the material risks affecting the target assets, which can include a range of issues spanning contracts, litigation, environmental, insurance, real estate, regulatory, labor, product liability, intellectual property and tax matters.

The level of concern and scope of the examination varies depending upon the nature of the investment and the structure of the transaction (e.g. leveraged buyout, pre IPO financing, venture capital investment, etc.).

From a legal perspective, it is also important to focus on the structure of the underlying transaction and contemplated exit strategy and how it affects the co-investors (including tax consequences and liabilities), with a focus on terms such as indemnities and holdbacks, the regulatory environment, necessary consents and approvals, debt leverage and financing, etc.

We have represented institutional investors and family offices in hundreds of sizeable co-investments all around the world. We have assisted our clients in co-investment transactions involving a large number of the world's most prominent global private equity sponsors and as a result, understand how those sponsors and their counsel operate and the deal terms that at any given time represent "market."

If you or your firm is interested in co-investment opportunities, we are happy to discuss how to prepare to access those opportunities and how we can be of assistance in executing them.

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