Family Office Insights
The Family Office and Its Lawyers Part 1 – Inside or Out?

As is the case with any sophisticated business enterprise, a family office will have a variety of legal needs to address in the course of its operations, and will need legal advice from specialists across a wide range of specific substantive legal areas. As family offices grow in sophistication and complexity, they will increasingly face a question that has long been encountered by other business enterprises: What legal functions should be outsourced and what (if any) legal functions can be most efficiently brought in-house?

In-House Counsel vs. External Service Providers

The fundamental question as to whether, and to what extent, the legal function should be brought in-house is not, in essence, any different for a family office than it would be for any similarly sized business enterprise. A company considering bringing its legal function in-house typically will look at factors such as the projected fully loaded employment costs (meaning salary, benefits, overhead and the like) of having in-house counsel as compared with the company's current and projected legal spend on outside lawyers, and factor in an analysis of the scope and nature of the company's anticipated legal needs.

For a family office, the analysis will start with the same economic question, but the unique nature of the family office model can make the decision, in many ways, much more complex.

Lawyers and the Family Office

In looking at the legal needs of a family office, the family's decision-makers need to consider not only the cost analysis described above, but also the particular legal profile and legal needs of the family. The fundamental analysis – beyond simply whether the family office has the economic scale to make the cost proposition work – is a determination by the family's decision-makers of what core legal functions they anticipate that the family will need.

It is axiomatic that no two family offices are exactly the same. The legal needs of a family office that is overseeing the management of one or more family-owned or family-controlled operating businesses will differ widely from a family office that principally operates as a custodian and investor of family wealth. Likewise, a family office serving a one- or two-generation immediate family will have a different legal profile, and widely differing legal needs, than one serving multiple generations of a founding family.

Core to the legal needs of almost every family office will be tax advice – income, gift and estate tax planning. For a family office that is principally involved with stewardship of a family's investments (rather than the ownership of operating businesses), the necessary tax support will likely extend to robust expertise on partnership tax issues. Beyond tax, however, a family office implementing a sophisticated alternative investment strategy will likely need state-of-the-art legal advice regarding corporate governance and transactional matters, including structuring and negotiating private equity, venture capital, and private funds investments and co-investments, debt finance and derivatives transactions, and real estate investments. Adding to the complexity of those legal needs, all of the legal strategies involved in those transactional matters need to be not merely harmonized with, but also optimized for, the family entity and trust structures developed through the family's estate and gift tax planning process. This means that a family office's legal team – whether internal or external – needs to be structured to provide close working coordination between the tax experts and the transactional lawyers, in order to ensure that the entry by family members or family entities into complex transaction structures does not create inadvertent estate or gift tax risks.

Can these functions be efficiently and cost-effectively brought in-house at the family office, or are they best addressed by the careful selection of external lawyers – or by some combination of the two? The answer to this question will depend on a careful analysis of the particular family's economics and mix of legal needs, but, regardless of the decision, each family office will need to assess the scope and nature of its family's requirements for legal services and assemble the right team of tax, transactional, finance and other lawyers to address those needs in a fully coordinated manner.

Coordination, in this context, means both the technical coordination between transaction and investment structures and estate planning at the tactical level and the coordination of the family's legal strategy at a strategic level. This need for coordination requires family leadership to consider what arrangement of counsel (or multiple sets of counsel) will not only provide the family with the ideal mix of top-drawer subject-matter expertise, but will also most effectively and efficiently coordinate the planning of estate, gift, and income tax strategies and entity structures across multiple generations of family members.

In addition to technical coordination, any well-functioning relationship between lawyers and their clients will involve a significant element of inter-personal compatibility and "fit." To ensure the coordination of legal strategy and planning across generations, family leadership needs to be mindful of the importance of facilitating the development of those relationships across the succeeding generations, and finding counsel who will be able to be trusted advisors to family members across multiple generations.

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