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# THE FAMILY OFFICE AND ITS LAWYERS

## Regulations and ethics

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**A**s 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? What are the legal, regulatory and ethical considerations when deciding whether to outsource work or keep it 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 harmonised with, but also optimised 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 facili-

tating 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.

### Legal and regulatory considerations

As is the case with any investment vehicle, a family office may be subject to a wide range of regulatory regimes depending on the nature of the investment it makes and the industries and jurisdictions in which it invests. As to the family office itself, in the United States there are typically only a limited number of legal or regulatory issues to be considered. The principal regulatory concern is the availability of the exemption from registration under the Investment Advisers Act of 1940, as amended (the Advisers Act). For a single-family office, no matter the manner in which it is structured from a legal entity standpoint, the concern, in a nutshell, is to make certain that the family office does not provide investment advice, as defined under the Advisers Act, to specified categories of entities or individuals such that the family office would be required to undergo the burdensome (and public) process of registration with the Securities and Exchange Commission as an ‘investment adviser’ and ongoing compliance under the Advisers Act. This analysis becomes more complex – and more critical – as the scope of the family office activities expand and the number of family members increases, and is of key legal importance for multi-family offices.

Apart from the regulatory issue posed by the Advisers Act, much as would be the case for the persons responsible for the legal function in any group of companies, the family office needs to ensure that the ‘corporate formalities’ are observed and maintained for all of the legal entities established by the family group. The general term ‘corporate formalities’ refers broadly to the formal legal steps to be taken by legal entities to substantiate their existence as separate legal entities: this suite of ‘corporate housekeeping’ matters typically includes such things as maintaining the legal good standing of each entity through the making of all required state franchise tax or similar filings, the maintenance of separate books and records for each entity, the regular election of directors and officers for each entity, the keeping of separate records of board minutes and resolutions adopted and actions taken by each entity, the documentation of any movements of capital among intra-family entities, and the maintenance of separate bank accounts and financial records for each entity. In the corporate context, these steps are important to ensure that the legal ‘separateness’ of each entity will be respected for purposes of liability limitation and financial responsibility. Those considerations are, of course, equally relevant for family entities – in addition, the maintenance of proper corporate formalities can help provide legal substance for intra-family transactions and help to mitigate the risk of inadvertent gift tax exposure.

This same concern applies equally to all intra-family



#### The quote

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transactions – whether they are investments or loans between entities owned by different members of the family, employment arrangements between family-owned entities and family members, or loans directly from family entities to individual family members. Part of the legal function of the family office should be to ensure that each such intra-family transaction is properly documented and, unless the transaction is intended to be a gift, reflects reasonable arm’s-length market terms, to mitigate the risk of a transaction being re-characterized, in whole or in part, as a gift for tax purposes.

### **Ethics and conflicts**

As to the lawyers themselves, whether in-house counsel or external, the family office, with its constellation of entities and individual family members all requiring legal advice, can present a special challenge – the ethical issue of conflicts of interest and the recurring question of ‘Who is the client?’ Providing legal advice to multiple generations of family members can present unique challenges to the ‘family lawyer’, and the family decision makers – whether senior family members or family office professionals – and the lawyers themselves need to be alert to potential conflicts of interest under the lawyers’ applicable rules of professional conduct. External counsel for a family office should carefully consider the terms of their engagement letter, and consider addressing issues such as whether (or the extent to which) they may represent individual members of the family, as well as the family’s entity or entities and, if so, for what purposes. For internal family office counsel, these can be even more difficult waters to navigate, and a written policy as to the scope of the professional services the in-house lawyer will perform on behalf of the various family office stakeholders can be a useful tool for establishing ethical guideposts. Although those agreements and policies, and written conflict waivers, joint representation agreements and other structural approaches can be valuable tools for mitigating the potential for ethical conflicts of interest and for avoiding intra-family disputes, it is almost inevitable that circumstances will arise in which the differing interests of family members will make it advisable to retain separate counsel, and identifying those circumstances and managing that process, when it arises, poses a unique challenge to the ‘family lawyer.’ **FS**

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