Corporate Counsel Business Journal
November ▪ December 2018
ccbjournal.com

CCBJ

Unique Experience Means Unique Insight Into Investment Management

▸ Akin Gump's Trey Muldrow and Fadi Samman have a combined 40 years of experience in corporate and investment management law. Here, they discuss the ways the two practice areas work together at Akin Gump, as well as some of the finer points of various primary and secondary market investment deals.

CCBJ: Can you each tell us a bit about your practice area and the path you took to some of the more exotic areas of the investment management ecosystem in corporate law?

Fadi Samman: I consider myself a traditional investment funds lawyer focused on private equity type strategies, although my practice is actually a little different than that of most traditional funds lawyers. Rather than focusing just on fund formation for sponsors, or just representing investors, I've always represented a healthy mix of both investors and sponsors, which has given me a unique perspective on the industry, in particular the private equity arena.

This has opened the door for me to do some interesting transactions beyond traditional fund formation or limited partnership investments. One area is the secondary market, where I started to help clients sell fund interests nearly 15 years ago, in particular for GE Capital. They were quite an active fund investor and were active on the sell side. Building off of that, I've had the opportunity to work on a variety of interesting transactions for buyers, sellers and sponsors. About two years ago, we worked on a deal for Mubadala Capital, the private equity arm of the Abu Dhabi sovereign wealth fund, whereby Mubadala launched their third-party investment management practice on the back of a stapled secondary transaction that syndicated out exposure to their existing private equity portfolio and raised third party capital.

Trey Muldrow: I am a commercial lawyer focusing on mergers and acquisitions. One of the things that makes Akin Gump unique, especially in New York, is that there is a very strong confluence between our investment management practice and our transactional M&A practice. I've had the opportunity to complete regular-way M&A transactions, of course, but also transactions that have involved investment funds that are seeking liquidity solutions for their limited partners or the general partner.

Akin Gump has a deep corporate practice and an investment management practice. How does your expertise fit in there, and what advantages do your clients gain from it?

Samman: The investment management industry is such a key component of the overall client base here at Akin Gump. Nearly every lawyer in the firm touches the investment management industry in some way. That gives us a real advantage across our practices, and particularly in corporate, because we are not only bringing general corporate and M&A experience but also a unique understanding of the industry and what our clients' needs are. Secondary transactions are a great example. Although they're related to the investment funds industry, at their core they're M&A transactions. Being able to bring in someone like Trey to help us think critically about what an M&A transaction

in the context of a fund looks like – that gives our clients something unique.

Muldrow: I totally agree. We see unique trades and investment opportunities, and nothing is boilerplate. That has allowed us to work with clients who are engaging in complicated, unique deals, as Fadi said. And many of the documents and structures that we've used for prior transactions are used throughout the market and are a benchmark for firms as they attempt to do similar transactions. Both Fadi and I have been brought in to serve as special counsel when other firms don't have comparable expertise to our firm. It's really a testament to the fact that our firm's lawyers haven't been siloed into only doing work for strategic companies or only private equity funds, but rather a mixture of both.

Clearly, there are perceived strategic and financial advantages driving investors to make transactions in markets such as private equity secondary funds. What are those advantages, and can the growth we're seeing be expected to continue?

Samman: Indeed, this has become a very well-developed market with many buyers and a high volume of transaction activity. Pricing is becoming increasingly transparent, which is great, because in some ways one of the hallmarks of private equity has been that it is illiquid – but the secondary market provides a solution. What has been really interesting is the evolution of the secondary market from one-off limited partnership sales to more complex transactions, and now the general partner is becoming a meaningful player in the process. Historically, the general partner has sat on the sidelines and would simply approve a limited partner sale.

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Now the market has created these general partner-led secondaries or fund restructurings that are really initiated by general partners who are seeking to provide limited partners with a liquidity solution. We see that market continuing to grow.

Muldrow: Another thing that's interesting to see is how creative people have been on the sponsor side of these transactions. They're saying, "We can give you a full-asset solution. We can give you a partial-asset solution. We can give you a solution where if the limited partner group doesn't want to own this anymore, we can take this off your hands."

Samman: What's fascinating to me is the illiquid nature of the asset class and the arbitrarily finite life that equity funds typically have. For example, a ten-year fund life is an arbitrary date. Funds rarely end at year 10. We'll always get to end of year 10 and look at the assets and say, "Well, what do we do now? There're some good assets there. They need more time." Or consider the market cycle: Perhaps it's the wrong time to sell to generate proper value. There's a variety of issues that dovetail from that. The market has been creative in generating opportunities out of that. We have dedicated funds and investors who are looking to create opportunities out of that aspect of private equity funds – the fact that by their nature they are illiquid investments but that you have investors who ultimately do want some level of liquidity after a certain amount of time.

One analyst recently issued a report saying that the secondary market is an easier path into private equity for investors seeking higher rates of return. What is the relationship between secondary funds and funds of funds, and what are the relative advantages and drawbacks for investors? What are the risks and how can you help clients mitigate them?

Samman: Primary funds of funds are principally focused on finding good private equity fund managers to go out and make new investments. The principal focus is on underwriting the manager and their strategy. A secondary fund is very different, although obviously the underlying manager is a relevant factor. But secondary

funds are investing in existing assets: funds that already hold investments. So the key component of the analysis is what assets the funds hold, what price am I going to pay, and what the future value of those assets is likely to be. The idea that secondary funds might present a better path to returns is related to what folks usually call the J curve. In a primary fund, the returns can be negative in the early days because of the drag created by expenses, and the returns come later in the fund's life cycle. If you buy into a fund that's already been funded and invested in, you can mitigate the J curve for that period of time. However, caution is warranted, because in a secondary transaction what matters is the price you pay. If you pay too much for the asset, your returns may not be good. In fact, in some ways, it can be a more difficult path because the due diligence and underwriting of the investment are more complicated. Certainly there is a path to potentially better rates of return, if it's done correctly, but I'm not sure I would say it's easier.

Clearly due diligence is vital when it comes to complex transactions involving private investors. What are the unique aspects of conducting due diligence in the private investment firm environment?

Muldrow: This is something we've had to learn with a bit of trial and error. With some of the secondary transactions or general partner-led transactions, there aren't opportunities for traditional M&A deep-dive due diligence. It's not something the general partners really want to entertain, and more importantly, there either isn't time or, because of the breadth of assets involved, you just don't have the ability to conduct a more intensive analysis. One of the things we try to do instead is to provide a high level of understanding of the assets to be acquired, which helps ensure that the transaction can be consummated. Whether it's the sale of a suite of assets, or maybe an upper-level sale of some entity that owns the assets, we make sure our client knows what they're going to own after closing. On the buy side, we seek to ensure that the buyer acquires what they expect to acquire and that they can do it on a timely basis without expensive approvals. Accordingly, there is a modified level of due diligence, and I think that the industry is coming to a general understanding of what the seller is willing to provide and what the buyer is seeking to receive.

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—TREY MULDROW

Samman: Looking at the diligence exercise from a legal perspective, it depends on the type of secondary transaction. When buyers are simply buying fund interest from other limited partners, it is principally a commercial diligence exercise. The legal diligence is fairly limited, and the access to information is very limited. When we get into the more complex transactions, it's a balance. The ability to do a deep dive on the underlying assets is limited, as Trey noted, but by the same token, there is an effort to at least get a look at the underlying assets to ensure that what you're buying is, in fact, what you think you're buying.

In the early days of fund restructurings, when there were fewer players on the buy side, buyers were able to look under the hood more and demand more. As the deals have become more and more competitive, buyers have had to become less intrusive. So, we're finding that the due diligence on these more complex deals, while it's not quite as limited as it might be in a traditional secondary deal, is moving in that direction and becoming more similar to the light level of legal diligence that you might see on a traditional secondary fund transaction. Frankly, buyers are having to take more risk right now given the competitive nature of the market. ■