INTRODUCTION:

College and university endowments and their investments must be managed with an appropriate level of care. Generally, in-house counsel must review such investments before they are made or take responsibility for securing review by outside counsel. Yet it can be difficult for legal counsel to have the expertise needed to understand the legal and economic terms of specific investments. These difficulties can, in turn, mean that endowment administrators risk making investments without fully understanding the economic terms of such investments. One area presenting unique challenges of this sort is private investment funds, generally referred to as “private equity funds” or “venture capital funds.” Collectively, such investments often represent some of the largest financial commitments of an institution, and failing to understand the fine print of these investment agreements could cost an institution hundreds of thousands of dollars in just one private equity fund investment, and millions over an entire portfolio.

This NACUANOTE discusses some of the factors that may lead colleges and universities to invest in these funds without fully understanding them. It then focuses on one particular issue – the fine print related to management fees and other expenses in these funds. Investment funds with this fine print can cost endowments measurable amounts of money in comparison with funds that do not have these terms. The last section of the Note provides practical suggestions for handling this particular issue to guarantee the integrity of your institution’s endowment, which counsel may wish to discuss with their Chief Investment Officers or other campus administrators.

DISCUSSION:

I. Factors Affecting the Review of Investments in Private Equity Funds

Several factors can affect the review of investments in private equity funds, some of which are inevitable, given the highly specialized expertise required to tackle these complex investment documents, and some of which are based on misconceptions about the clarity and quality of the agreements that are offered to an institution in the first instance and the negotiating clout even a small investor may possess.

The whole area is usually unfamiliar to in-house counsel, and this lack of familiarity can be inhibiting. Moreover, the investments are often recommended by outside financial advisors, and counsel may assume that these advisors provide expert legal, business, and tax review of the funds. In fact, such advisors do not do so and do not have the expertise to do so. [3]

In addition, there is a tremendous misconception that a relatively small investor in a large fund (e.g.,
an endowment investing $5 million into an $800 million private equity fund) has no negotiating power. In fact, counsel representing relatively small investors routinely secure changes in agreement terms. The fund may not agree to all the investor’s requests, but changes to agreements are common, especially when they are made in a reasonable attempt to protect the investor.

Another misconception is that smaller investors can rely on large investors to make sure the terms are reasonable and appropriate. But again, this is not the case in reality. It is not uncommon to find terms in need of revision even when dealing with, for example, an $800 million fund that has already closed on $400 million of commitments – because no one raised these issues in the first closing. [4]

Finally, the contracts governing these investments (the fund’s partnership agreements) are long, complicated documents – 60 to 120 pages – intended to cover a ten-year business partnership with large sums of money at stake. They are sometimes drafted with a bewildering profusion of specially defined terms and cross-references. If a reviewer misses even a short phrase in the document, he or she can misunderstand a major item. Moreover, the economic terms are embodied in the distribution and allocation provisions, which involve specialized tax and accounting concepts. Even people who have read and drafted hundreds of these agreements may still find them difficult to read and understand. The understandable result of all these factors is that some endowments may commit to tens or hundreds of millions of dollars in such investments without fully understanding the details of the fund’s partnership agreement. [5]

II. How to Lose $400,000 on Signing a Subscription Agreement

This NACUA NOTE will focus on one particular arrangement seen in a growing number of funds in recent years, where the fund charges management fees and sometimes other expenses to the investors without giving the investors a compensating share of profits to pay back these expenses. This is a change from the traditional practice, and the reasons behind this change will be explained later in this Note. [6] But the bottom-line economic impact of this issue is significant: An investor making a $10 million commitment to a fund with this fee scheme has effectively lost $400,000 upon signing the subscription agreement in comparison with the same commitment to a fund with a traditional payback of management fees.

A. Basic Economic Terms of a Private Equity Fund

As background, it may be helpful to summarize the basic economic terms of a private equity fund. Investors sign a subscription agreement promising to contribute a fixed amount of capital. Most of this capital commitment will be contributed over an initial investment period (typically three to five years). These capital contributions are not made on a regular schedule, but in various lump sums as the fund needs the capital to fund its investments and expenses. At such times, the fund issues a “call” to the investors to make the contributions (usually on about 10 days’ notice). After the three to five year investment period, the balance of the capital commitment cannot be called to make new investments, but only for the purposes of supporting earlier investments and to pay expenses.

The fund operates by making, for example, 15 or so investments over five years, and then gradually selling them and distributing the proceeds over the next five years.

For our purposes, it will be simplest, for the moment, to assume that all funds make distributions of cash [7] as follows: First, investors receive back all of their invested capital. Once they have that back, they often are entitled to receive a preferred return (e.g., an 8% annual return) on their capital. Then the general partner (the fund sponsor and manager) is entitled to a so-called “catch-up,” in relation to the preferred return. Finally, any remaining profits are split generally 80% for the investors and 20% for the general partner. For simplicity here, we can ignore the preferred return and the catch-up and instead assume all funds are intended to return capital and then split profits 80% to the
investors and 20% to the general partner (the “carried interest”). This is an example of the “traditional” economic split.

At this point, an example of this “traditional” economic split may be helpful (for convenience, this example will follow the common practice of referring to the fund sponsor/general partner as the “GP” and the investors as “LPs” given that many of these funds are limited partnerships).

Suppose the LP invests $10 million over the life of the fund. Of that, $8 million is invested in investments, and $2 million is used to pay management fees and expenses. The $8 million invested is sold to realize $20 million of distributable proceeds. If all the profits, losses, and expenses were aggregated into one pool, then there is $10 million of total profit. The LP gets its $10 million of capital contributions back. The additional $10 million available to distribute – the profit – is split 80/20, with $8 million for the LP and $2 million carried interest paid to the GP.

In tabular form:

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
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<tbody>
<tr>
<td>LP Initial Investment:</td>
<td>$10,000,000</td>
</tr>
<tr>
<td></td>
<td>-$2,000,000</td>
</tr>
</tbody>
</table>
|                          | $8,000,000  | (Available for Investment)
| Yield on $8,000,000:      | $20,000,000 |
| Return to LP:             | $10,000,000 |
|                          | $8,000,000  | ($10,000,000 Less 20% GP Carried Interest)
|                          | $18,000,000 |
| GP Carried Interest       | $2,000,000  |

This example describes a traditional “one-pool” fund. It pays the carried interest “net of fees and expenses,” since the fund must repay the $2,000,000 spent on such fees and expenses before the GP is entitled to receive its carried interest.

In practice, various distribution schemes can be used, and analyzing the resulting economic deal may be difficult. One must look not just at the distribution scheme, but also at allocations (discussed below). Further it is important to consider various potential patterns of investment and realizations.

For example, even in the simple pattern above, suppose the investor had invested $9,000,000, and received back all of it. In addition, there had been $10,000,000 of profits (net of fees and expenses), and this had been distributed $8,000,000 to the LP and $2,000,000 to the GP as a carried interest. Then after such distributions have been made, late in the life of the fund, the fund calls the final $1,000,000 left in the LP’s unfunded commitment, and this $1,000,000 is lost and not recovered. On this pattern, the apparent “guarantee” of getting all the LP’s capital back first in the distribution scheme proves illusory. In this case, the fund agreement needs to include a clawback on which the LP can collect from the GP, in order to preserve the intended economic deal. Net profits (net of fees and expenses) turn out to be $9,000,000, not $10,000,000. Thus, the GP should, upon liquidation of the fund, pay back $200,000 of the carried interest which it received. This pay back obligation is embodied in the so-called “clawback” provisions of a fund agreement.

Thus, in order to understand the economic arrangement of a fund, that is, the final economic division of who gets the cash, one needs to take into account the distribution provisions, the allocation provisions, the liquidation provisions, the clawback provisions, and the various timing possibilities and transactional patterns of calling capital, investing capital, and realization of income and losses.
B. Two-pool Funds

In contrast to the one-pool fund described above, we turn now to an alternative arrangement, more favorable to the GP, which we shall refer to as the “two-pool fund.” In this case, the GP earns its carried interest from the investment profits, but these profits are not netted down for the management fees and expenses. The GP earns its carried interest from the “gross investment profits,” and the calculation of the carried interest simply ignores any need to return management fees and expenses to the LP. These fees and expenses are removed to a separate pool. Thus, if there are two pools, and the investment results are the same as above, the outcome, as between the GP and the LPs, looks quite different from the one-pool scenario above.

The LP again invests $10 million over the life of the fund, $8 million of which is invested, and $2 million of which is used to pay management fees and expenses. The $8 million invested is sold to realize $20 million of distributable proceeds, as before. However, in this case, the arrangement provides for both a pool for calculating gains and losses attributable to investments, consisting of the $20 million ($8 million of invested capital and the $12 million profit), and a separate pool consisting of the $2 million loss for management fees and other expenses. The first pool provides for its $20 million to be split as follows: it returns the $8 million of invested capital to the LPs and the $12 million profit is split 80/20. So the GP is paid a $2.4 million carried interest – $400,000 more than if all profits and losses had been aggregated in a single pool. What happens to the $2 million of capital contributed by the LPs to pay the management fees? It is accounted for separately, and the GP is not obligated to use some of the $12 million in profits to repay this money before being paid the carried interest.

In tabular form:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>LP Initial Investment:</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Management Fees and Expenses</td>
<td>-$2,000,000</td>
</tr>
<tr>
<td>Available for Investment</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>Yield on $8,000,000:</td>
<td>$20,000,000</td>
</tr>
<tr>
<td><strong>First Pool</strong></td>
<td></td>
</tr>
<tr>
<td>Return to LP:</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>(Initial Investment Less Management Fees and Expenses)</td>
<td></td>
</tr>
<tr>
<td>$9,600,000</td>
<td></td>
</tr>
<tr>
<td>$17,600,000</td>
<td></td>
</tr>
<tr>
<td>GP Carried Interest</td>
<td>$2,400,000</td>
</tr>
<tr>
<td>Second Pool:</td>
<td>-$2,000,000</td>
</tr>
<tr>
<td>(Management Fees and Expenses Subject to Separate Accounting and Not Used in Calculation of Return to LP, Resulting in Additional $400,000 for GP.)</td>
<td></td>
</tr>
</tbody>
</table>

Another example, with poorer investment returns, may also be helpful in illustrating the consequences of a two-pool fund.

Suppose the LP again contributes $10 million, but this time the $8 million invested in portfolio companies yields a total of $10 million to distribute – $8 million return of invested capital and $2 million profits. In a one-pool fund, the whole $10 million will be returned to the LP to pay back the $8 million invested and the $2 million used to pay management fees. In a two-pool fund, the GP receives $400,000 (a 20% carried interest on the $2 million of investment profits), and the LP receives $9.6 million. The LP actually ends up losing money, yet the GP receives a carried interest of $400,000 as a reward for an ostensibly successful investment program.
As the examples above illustrate, it is critical for counsel and other endowment administrators to be aware of the differences between, and consequences of, these two methods.

C. How to Spot a Two-Pool Fund

One would think that such a large economic difference would be easy to spot and bring up as an issue with the GP. Sometimes it is, but there is also a considerable variety of drafting techniques and terminology used in fund partnership agreements, and the two-pool result in particular may be achieved by more than one means. So what should counsel and administrators look for to determine if an agreement includes a two-pool method? In truth, there is no avoiding the need for a comprehensive understanding of all the terms and transaction patterns. Nonetheless, a few of the most common elements in a two-pool fund are worth mentioning.

**Liquidation Provisions.** One of the most common elements in two-pool funds is that they liquidate in accordance with capital account balances. For example, the distribution section of the partnership agreement (often referred to as the “waterfall”) may require that (i) first, all cash be distributed to the LPs until the LPs have received aggregate distributions equal to their capital contributions, and (ii) thereafter, all additional cash be distributed 80% to the LPs and 20% to the GP. Yet this distribution waterfall may present a misleading and incomplete picture of the fund’s true economics. This is because some funds liquidate by distributing their cash to the LPs and GP in accordance with capital account balances, and this liquidating procedure will in the final stages of the fund override the usual distribution waterfall. Thus, the final amounts of cash may in fact be distributed 70% to the LPs and 30% to the GP (or some other ratio). A fund agreement need not have (and usually does not have) an explicit statement that the provision requiring liquidation by capital account balances overrides the distribution waterfall in the final stages; it is implied, such that non-liquidating distributions made under the distribution waterfall are in fact always subject to limitation by capital account balances (as a matter of standard drafting conventions). As a result, the distribution waterfall will simply not be describing the true economic terms of the fund. Instead, the allocation provisions will determine who gets the cash at liquidation. [11] The following paragraph summarizes the allocation of profits and expenses to the capital accounts of the GP and LP, as a illustration of how, in the end, this mechanism of allocations to capital accounts determines the final cash distributions to each party. Liquidation by capital account balances should always be a flag to make sure the allocations give an LP the expected economic deal. [12]

**Special Allocation of Management Fees.** In a two-pool fund, there will typically be a special allocation of management fees and other fund expenses entirely to the LPs (or sometimes the GP is included, but its share of the expense allocation is proportionate to its capital commitment, e.g., 1%). This allocation of expenses reduces the capital account of the LPs and thus reduces their final cash entitlement when the fund liquidates. As a result, if -- to use the same investment results as above -- the LP invests $10 million and is allocated the $2 million management fee expense, then over time its capital account is decreased to $8 million. The $12 million of profits is allocated 80% to the LP, giving it a final capital account of $17.6 million. The GP is allocated 20% of the $12 million profits and is thus distributed $2.4 million of carried interest. Again, distributions will be made in accordance with the distribution waterfall for most of the fund’s life, but in the final stages they will follow the allocations to capital accounts -- final cash, in the two-pool fund described here, will not be distributed 80/20, but rather 70/30 or some other ratio. [13]

**The Fine Print.** The special allocation of management fees and other fund expenses in a two-pool fund is often difficult to detect. Thus, some fund agreements do not have an express statement in the allocation provisions providing for a special allocation of management fees to the LPs. Instead, they achieve the same effect by other means.

For example, some fund agreements take a typical minor concept, knows as “short-term income,” and
transform it into a vehicle for effecting this shift in economic terms. In many fund agreements, including traditional one-pool funds, within the list of defined terms, there is a term defined as “Short-term Income and Loss” or “Other Income and Loss.” Now most funds define these terms to mean the interest income earned on cash held by the fund in the bank for brief periods (e.g., 30 days) when capital has been called from the LPs but not yet invested, or when an investment has been sold but the cash received has not yet been distributed. In such cases, the Short-term Income and Loss account is expected to have a slight net profit, and this income is often allocated and distributed to the LPs only. That is, it is distributed outside the distribution waterfall, and the GP is not entitled to earn any carried interest on it. It is, strictly speaking, a second, segregated pool of profits, but one that does not harm the LPs and indeed gives them a slight benefit. [14]

However, some funds turn this Short-term Income and Loss account to a very different use. They do so by amending this obscure definition to achieve the results described above for a two-pool fund paying the GP a larger carried interest. For example, “Short-term Income and Loss” may be defined as, “Short-term interest income earned on cash temporarily held by the Fund pending investment or distribution (net of Management Fees and other general Fund expenses).” In this version, the Short-term Income and Loss account is fully intended to run at a substantial loss, since the Management Fees and expenses charged to it will greatly exceed the short-term interest income. [15] This net Short-term Loss is allocated to the LPs under a special allocation provision, which therefore does the same work as a special allocation of management fee expenses would do – it reduces the capital accounts of the LPs so that they pay the GP a higher carried interest. Missing, or misunderstanding, the phrase about management fees and other expenses, which may sometimes be found buried in parentheses in an obscure definition of “Short-term Income,” can mean missing this $400,000 item. [16]

D. Origin of this Practice – GP Tax Planning; Practical Suggestions

The origin of this practice, of GPs seeking to charge the LPs with these management fees, lies in a tax problem affecting the GP. The GP will generally have difficulty taking a full tax deduction for management fees and other expenses allocated to it. The result, in a one-pool fund, is that the GP can receive a cash distribution of $20 of carried interest and be taxed on $24 of taxable income. [17]

Many, including this author, think it is reasonable for the LPs to cooperate to some extent in the GP’s attempts to avoid this anomalous tax result. However, a good compromise, which should avoid the large costs described above to the LPs, is to insist that the management fees and general expenses charged to the LPs as allocations be made up by subsequent special additional allocations of capital gain items to the LPs. [18] These allocations are made as a priority allocation, meaning that each year to the extent that there are available profits, they are allocated to provide a make-up allocation to the LPs for the fees and expenses charged to the LPs. Such a compromise solves the GP’s tax problem, but not at the cost of imposing such an economic loss on the LPs. [19] Thus, LPs should ask for this compromise as a minimum, since it solves the GP’s tax problem and can go a long way toward restoring the economics of a traditional one-pool fund. [20]

More conservative investors seeking to reduce their risk of the losses imposed by a special allocation of management fees and expenses could request that the fund change this provision, or alter other distribution and allocation provisions to achieve a similar effect. Some fund managers are willing, given enough investor interest, to abandon the two-pool approach altogether in favor of a one-pool fund. Keen GPs may realize that the marginal benefit achieved with a two-pool approach could jeopardize the long-term sense of partnership at the foundation of the GP-LP relationship. Certainly an LP should always be aware of this issue in a fund and, probably with rare exception, should always seek to have it abandoned or modified.
CONCLUSION:

Counsel and administrators responsible for college and university endowments need to understand the obligations, difficulties, and opportunities involved in the process of investing in private investment funds, so as to determine if their investment program is engaging in the appropriate level of business, economic, legal, and tax review. Given the complexity of these agreements, the necessary reviews should involve an especially intense collaboration between counsel and endowment managers.

This NACUANOTE has focused on one very specific issue, from among a longer list of items which would normally be reviewed, partly for its own sake as a material economic term, and partly as an illustration of the difficulties involved in performing a sufficiently expert review. The practice of not paying back management fees and other expenses to investors seems to be a case of the fund sponsor (the GP) attempting to address a legitimate tax problem, but going beyond what is needed and causing a significant economic shift to the disadvantage of the investors. Fortunately, there exists a compromise in the form of the investor requesting a make-up allocation to the LPs. Investors may also take a harder line and push to have the two-pool approach abandoned.

Even when endowments cannot effect such a change in the terms, they have an obligation to understand the legal and economic terms of the fund. Counsel and administrators always want to be able to show that they understood the economic ramifications of their decisions, and a memo to file indicating that the terms were understood when the final decision was made to invest in the fund will go far in achieving this.

Such a memorandum will also assist in forming your comments in the pre-marketing stages of a manager’s next fund. Generally the earlier an issue is raised in the fund formation process, the better chance the LP has to get an accommodating response from the GP. Thus, investors may find it effective to raise this and other issues in advance of the preparation of the documents for the next fund, or in the early stages of formation for the next fund.

FOOTNOTES:


FN2. This Note will refer simply to private equity funds, but the issue discussed here applies to venture capital funds, lending funds, real estate funds, oil and gas funds, infrastructure funds, and other similar funds organized as limited partnerships or limited liability companies. The issue focused on in this Note does not generally apply to hedge funds, although hedge funds obviously present their own set of issues to be addressed.

FN3. All private investment funds prepare an offering memorandum, and many people involved in the investment process, both outside advisors and internal investment staff, rely on the offering memorandum to understand the economic and other terms. One of the tasks of a reviewer of a fund partnership agreement is to confirm that it provides the economic terms, investment limitations, key person provisions, conflict of interest rules, and other terms as advertised in the offering memorandum.

FN4. Not all investors push for better terms from the fund sponsor. For example, a fund-of-funds (an investment fund which invests in other private equity funds) may have a primary
interest in establishing and/or maintaining access to a particular manager. Despite their writing large checks, negotiation on fund terms by these types of investors may be light even compared to a much smaller investor.

**FN5.** Sometimes even the fund’s attorneys have trouble understanding the documents. This author recently asked for clarification from a fund’s counsel as to whether the fund was intended to be a two-pool fund (as described below), two days before the final closing. Despite having drafted the document, counsel was unsure of the intended economic deal. Other investors had clearly been oblivious to the issue.

**FN6.** The fee arrangement discussed in this Note is not brand new, and some funds have used it for a long time. But in the author’s experience, it has been growing in recent years.

**FN7.** Funds may at times distribute the stock of portfolio companies in kind, but this Note assumes all distributions are in cash.

**FN8.** The description above is of the traditional intended final economic split. It is not necessarily a description of the actual distribution scheme, which may not distribute all capital back to the investors first and may instead allow the general partner to receive advance payments toward its 20% carried interest (prior to paying back all invested capital to the investors). A claw back imposed upon liquidation of the fund is supposed to guarantee to the investors that excess advance distributions of the carried interest are returned to the investors upon a final reckoning of the aggregate profits and losses.

**FN9.** Discussion of the proper drafting of clawbacks is beyond the scope of this Note. The example is included to show how the sequence of investments and realizations needs to be considered when analyzing whether a fund agreement’s distribution and allocation provisions provide the expected economic deal between the GP and LPs.

**FN10.** In addition to understanding who get the cash, a proper financial modeling of an investment in such a fund should obviously consider the generally expected timing of distributions.

**FN11.** “Allocations” to capital accounts refers to the tax accounting technique of attributing a share of each years’ profits (or losses) to each partner; it does not itself involve the movement of cash; it is a recording of profits on the books of the partnership; in the case of a fund liquidating by capital accounts, this accounting action is then used to determine who gets the cash (in place of the distribution waterfall).

**FN12.** Funds liquidating by capital account balances may short-change the LP in other ways than the failure to pay back management fees. For example, a failure to allocate losses to the GP, to reverse earlier allocations of the carried interest, will allow the GP to have an excess capital account balance on liquidation in respect of its carried interest. That is, the GP will be entitled to more than the intended carried interest percentage.

**FN13.** Of course if one looks at the ratios for all cash distributed after the return of $10 million in capital contributions, the ratio is 76% for the LPs and 24% for the GP (since the GP received a carried interest of $2.4 million of the $10 million in overall profits, if all items are aggregated). In practice, no doubt a good deal of the profits would be distributed 80/20 as nonliquidating distributions under the waterfall, so the GP would receive a higher percentage in the final stages to get up to 24% of the aggregate profits.

**FN14.** The discussion that follows in the text, however, continues to use “two-pool fund” to refer to
the economic arrangement described in Section B above.

**FN15.** This loss if funded by capital contributions from the LPs. In terms of our example in Section B, this short-term loss pool is funded by the $2 million in capital contributions from the LPs used to pay for management fees and expenses (if we ignore the slight offset achieved by the interest income earned, too). In short, the cash flows and economic results are substantially the same as the second pool in our example in Section B above, with the only real difference being the words used in the fund partnership agreement to achieve this result.

**FN16.** This discussion is not meant to imply that funds are concealing the intended economics, insofar as the terms are generally there in black and white, so long as one has the necessary expertise to review the documents. However, this two-pool effect is never highlighted or emphasized in agreements, and thus is often missed by LP investors. Further, a manager may state with confidence that investors receive a return of contributions before the GP takes any carry (referring to the distribution waterfall), but fail to emphasize the economics embedded in the allocations and liquidation provisions. The nuance can be confusing for investment and legal persons alike.

**FN17.** This comes about because the GP is allocated, say, $24 of gross income items, and a $4 deduction for management fees, netting to $20, its cash entitlement as the carried interest. Yet, due to the disallowance of the $4 deduction for federal income tax purposes, the GP owes tax on $24 of income. The loss of deduction is due to limitations on investment expenses under Sections 67 and 68 of the Internal Revenue Code.

**FN18.** There are technical tax rules (the so-called “substantiality” rules) which dictate the use of capital gain items as a safe source (under the tax law) for such make-up (offsetting) allocations to the LPs.

**FN19.** The idea is that in years 6-10 as the fund realizes capital gains by selling investments, a special additional amount is allocated to the LPs ($2 million in our example) to give their capital accounts an extra boost, paying back the $2 million spent on management fees by giving them a right to be distributed this extra $2 million upon liquidation. This result restores the economics of a traditional one-pool fund. This compromise may still cost the LPs some economic loss in comparison with a traditional one-pool fund, since the LP is not made whole to the extent that some management fees are paid in the final stages of the fund and no capital gain is realized to make up these fees to the LPs in either the year they are paid or a subsequent year before the fund liquidates. But the amount of loss, at least for a fund realizing some capital gain in a fairly late year, will be a small fraction of the loss otherwise. Of course some LPs will resist even this smaller potential loss. It should be remembered that the tax rules allow considerable flexibility to fashion compromises. For example, the potential loss from not receiving a make-up allocation on management fees charged to LPs in the later years of the fund could be eliminated by requiring that in the last two or three years of the fund, management fee expenses will not be charged specially to the LPs.

**FN20.** There are other solutions used occasionally, too, so as to avoid the GP’s tax problem and at the same time prevent the LPs from suffering such an economic loss. Part of the management fee may be turned into a profits interest, or such fees may be paid by LPs directly, not by the fund.

**FN21.** Again, the intended economic arrangement cannot be fully understood without an in-depth review of the allocations, distributions, liquidation, and clawback provisions, along with consideration of the expected investment patterns.
"To advance the effective practice of higher education attorneys for the benefit of the colleges and universities they serve."