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# PRIVATE EQUITY FUNDS

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# Introduction

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Private equity funds represent a major source of investment capital for a broad array of business transactions, ranging from venture capital start-ups to leveraged buyouts of large public companies. The vast number of transactions involving private equity funds reflects the development of these private investment vehicles—once known only to pursue the purchase of equity securities of privately owned companies. Private equity funds are also extremely successful businesses in their own right. Funds are generally partnerships consisting of managers (or general partners) and investors (or limited partners). Managers of funds are compensated for identifying, monitoring, and effecting dispositions of investments, while investors in private equity funds seek a return on their investments, after sharing profits with the managers, from the success of underlying investments made by private equity funds.

This book is intended to serve as a practical resource for participants forming and operating private equity funds. These participants consist of advisers to funds, including attorneys, accountants and placement agents, managers of funds, and investors in funds. The formation and operation of private equity funds involve compliance with numerous securities laws and partnership laws, complex structuring under tax laws, and, of equal importance, practical guidelines. Notably, a private equity fund is not a publicly traded vehicle, and it relies on regulations exempting it from registration requirements for securities and mutual funds. Practicalities are driven by investors' tax or other structural and legal requirements, and by the investment strategy of the fund. Although the book details the process of private equity fund formation, it also contains contrasts to hedge funds, another enormous private investment fund industry that continues to develop and to creep closer to the private equity fund industry, driven also by investors who may invest in both private equity funds and hedge funds. The formation and operation of private equity funds continue to be refined. At one time, private equity funds were noted to be acquiring certain attributes of hedge funds. The investment community regularly has referred to the "convergence" of hedge funds and private equity funds. The creation of "hybrid" funds—private investment funds structured partly like hedge funds and partly like private equity funds—reflects such convergence. However, this converging trend has not been as significant as in recent periods. The private

equity fund industry is, nevertheless, likely to continue to evolve in order to address managers' goals and expectations of investors. The alignment of interests between managers and investors is a key factor in forming private equity funds.

The book is organized by first providing background on private equity funds, particularly the many types of private equity funds. It then contains a lengthy discussion on economic terms, followed by advice on choosing the types of entities involved in formation of funds, issues relating to employment matters, and the preparation of fund documents. Thereafter, the book addresses the many regulations that apply to private equity funds, including compliance programs for investment advisers, private placement rules for the sale of unregistered limited partnership interests in funds to investors, exemptions to registration requirements of investment funds, regulations relating to investment advisers, broker-dealer rules, filing requirements relating to public securities, ERISA matters, and anti-money laundering issues.

We have also attached examples of certain documents and provisions of documents used in forming private equity funds. While many of these documents and provisions are substantial duplicates of actual private equity fund documents, we caution our readers about copying these (or any) "form" legal documents. In every case, a document needs to address the specific agreement reached by the parties, and private equity fund documents can be heavily negotiated. Thus, the examples are intended to give a real sense of how private equity funds are created, but we cannot encourage our readers enough to seek advice from practitioners who work regularly, if not exclusively, in this area and who will be able to counsel their clients about the highly dynamic and changing private equity fund industry.

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