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The Consent Conundrum: Changing Control of U.S. Alternative Investment Advisers

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The U.S. alternative asset management industry[1] is undergoing a substantial transformation driven by several factors, including virtually universal registration of investment advisers under the Investment Advisers Act of 1940 ("Advisers Act"), increased regulatory scrutiny, market and performance volatility, the adoption of the Volcker Rule, heightened investor demands, several scandals, and a negative public perception. These factors have contributed to a resurgence in financial and strategic transactions involving investment advisers–from acquisitions,[2] to consolidations and lift-outs,[3] to spin-offs by banks.[4]

Parties planning an ownership shift of less than 100 percent of an investment adviser need to determine whether this would lead to a change in control. Change in control of a registered investment adviser always requires investor consent under the Advisers Act and applicable investment advisory documents. A failure to obtain adequate investor consents, whether required by contract or law, can have potentially severe consequences for both the investment adviser and the acquirer.

Notwithstanding the necessity of obtaining consents when required, the Securities and Exchange Commission ("SEC") has provided scarce guidance for the alternative asset management community on: (1) what constitutes a change in control of an investment adviser under the Advisers Act triggering the consent requirement; (2) which clients or investors must provide consent; (3) how to go about obtaining those consents; and (4) what are the implications of not obtaining required consents. Consequently, practices vary widely in this area.

Whether the decision to seek or not to seek consents is legally defensible, having investors[5] who are displeased by a transaction could reflect poorly on the investment adviser's reputation, increase the risk of future redemptions, and jeopardize efforts to raise new capital. Therefore, all things considered, technical consent requirements are merely the "kicking-off" point for developing a detailed client communications plan designed to convince investors that the proposed transaction serves their interests as well.

Triggers for Consent Requirements

Section 205(a)(2) of the Advisers Act does not expressly require client consent for a change in control of an investment adviser. Instead, it requires that each investment advisory contract *include a provision* that the investment adviser *may not assign* the investment advisory contract without the consent of the *client*. Technically read, therefore, the assignment of an investment advisory contract without client consent does not violate the Advisers Act.[6] However, under a more purpose-oriented reading, the Advisers Act could be construed to impose an obligation to obtain client consent even when the required anti-assignment provision is missing from the documentation. In addition, the failure to obtain consent, or notify the client of the transaction and give the client an opportunity to withdraw or redeem, could violate the fiduciary duties imposed on the investment adviser by the anti-fraud provisions of Section 206 of the Advisers Act.[7] As a consequence, while this distinction appears meaningful, advisers generally treat the obligation to obtain consent as if expressly required by the statute.

An "assignment" provision in a typical non-investment advisory agreement normally refers to some form of transfer of that agreement or rights thereunder. Under the Advisers Act (and related regulations), the "assignment"[8] of an investment advisory agreement is instead interpreted to cover a change in control of an investment adviser, whether brought about by a transfer of equity interests or otherwise,[9] including the transfer of a "controlling block" of voting securities, irrespective of whether a transfer of the agreement occurs.[10]

In determining whether a change in control will occur, practitioners usually base their analyses on the definition of the word "control" in the Advisers Act and related Rule 202(a)(1)-1 and by analogy, to the definition of "control" and the control presumptions contained in the Investment Company Act of 1940 ("Investment Company Act").[11]

"Control" under Section 202(a)(12) of the Advisers Act is defined as "the power to exercise a *controlling influence* over the management or policies of a company. . . ." Deciding what constitutes a controlling influence in practice requires an intensive factual investigation and analysis. While acquiring a majority voting stake would inherently constitute the transfer of a controlling block (even if investment management responsibility remains with the same individuals following the transaction), the acquisition of a large minority stake or a non-voting stake, and transactions that give the acquirer substantial affirmative veto, participation rights, and/or economic influence, may do so as well. Whatever "control" means, the SEC has specified under Rule 202(a)(1)-1 that only a change in "actual" control requires consent.[12]

Practitioners often look to the definition of "control" in the Glossary for the Form ADV which contains a presumption that "[a] person is presumed to control a corporation if the person: (1) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (2) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities."[13]

This 25 percent control presumption is merely a guide, and not a strict demarcation. The SEC concluded in a No-Action Letter issued to American Century Companies ("ACC") and J.P. Morgan Co. ("JPM") that a properly structured acquisition of 45 percent of the equity interests in an investment adviser may not result in a change in control or an assignment.[14] Conversely, transfers of less than 25 percent could be considered a change in control if accompanied by other factors demonstrating control. For instance, granting the acquirer an option to purchase a controlling block, exclusive long-term distribution rights for raising fund investments, or veto rights that exceed those permitted by the SEC in the ACC/JPM No-Action Letter could, in combination, constitute a change in control.

– No-Action Letter Guidance

Three primary SEC No-Action Letters address the issue of which transactions constitute a change in control and, therefore, an assignment under the Advisers Act. In the first,[15] the SEC concluded that the merger of two widely held public companies did not constitute an assignment of their respective investment advisory contracts. Because neither of the merger parties had a controlling shareholder, the transaction did not result in either a controlling person losing control or a new person obtaining control.

In the second letter, the ACC/JPM No-Action Letter mentioned above,[16] the SEC dealt with a specific set of control rights, and concluded that the granting of those rights to the acquirer was not sufficient to constitute an assignment. The SEC found that the acquisition by JPM of a 45 percent economic stake in ACC would not result in an assignment under the Advisers Act. The SEC's conclusion was informed by the fact that JPM's interest represented only 10.83 percent of the voting power in ACC.[17]

The SEC also focused on the extent to which JPM's veto rights were limited, commenting that such rights (1) did not grant JPM authority to manage the day-to-day operations of ACC–in particular, those relevant to the investment process, which is the primary focus for the investment adviser/client relationship; (2) only applied in extraordinary circumstances; and (3) were in the form of vetoes, rather than affirmative control rights, meaning JPM could not initiate action or direct ACC's activities.[18]

In the third SEC No-Action Letter,[19] the SEC announced that it would cease providing guidance in this area. The SEC concluded that it was not in the position to undertake those primarily factual inquiries.

– Practice Considerations

In analyzing whether a change in control will occur, one must examine a myriad of factors against the backdrop of prior disclosure and client expectations.

Practitioners first should focus on whether control over the investment process has been compromised–scrutinizing both direct control rights by the acquirer as well as its ability to impact or influence investment choices by other means, such as (1) the integration of legal and compliance functions; (2) the creation of reporting lines relating to risk management; or (3) veto rights over hiring, firing, and compensation. Practitioners also consider special commercial arrangements, such as exclusive distribution relationships.

Practitioners also should take into account the nature of the funds in question. A liquid fund that permits periodic redemptions presents far less exposure than a fund with less frequent redemption rights. With liquidity, the underlying investors have the ability to "vote with their feet" around the time of the change in control. Consequently, when feasible, practitioners attempt to time the closing of the transaction to coincide with a redemption period. Illiquid funds, private equity funds, and venture capital funds, however, generally cannot provide this redemption fallback.

Practitioners also ought to consider the extent to which, under the relevant documents, an investment adviser is permitted to delegate or assign its duties to a sub-adviser. Where delegation or assignment is so permitted, the parties to a transaction are sometimes more flexible in their approach to consents on the theory that the documents already contemplate third parties having some investment advisory functions.

Finally, the overall structure of the transaction can be crucial to the analysis. Multi-stage transactions–including those with installments, puts and calls, and earnout periods–are particularly thorny. Often in these types of acquisitions, the existing management of the investment adviser (often the sellers) will initially continue to have day-to-day control, subject to the acquirer's limited veto and consent rights. Once some or all of the full earnout or other purchase price is paid, day-to-day control typically transitions to the acquirer, while the sellers or current management may reserve limited veto or consent rights.

A multiple-stage transaction that initially does not result in an assignment may trigger a consent requirement as control shifts over time or at the inception of the deal. The parties usually seek consent to these transactions before the initial closing for convenience, since unwinding a transaction or dealing with the fallout from a failed consent at a later date may prove to be traumatic. Furthermore, obtaining consent initially eliminates any uncertainty that a change in control could occur unexpectedly, as a result of some event specified in the relevant documents (*e.g.*, sub-par performance, death or disability, or breach) and thus trigger a "surprise" consent requirement. As a practical matter, the consent process also helps ensure that current investors understand the transaction and have become comfortable with the upcoming changes.

Who Provides Client Consents?

Due to limited guidance, it is not always clear whether consent is required from the fund or the underlying fund investors (and if the underlying investors, how many or what percentage).

The language of Section 205(a)(2) of the Advisers Act effectively requires only that the "other party to the contract" consent to the assignment. Where a managed account[20] is involved, the investment adviser must seek consent of the underlying investor in the managed account. For a pooled investment vehicle, such as a private fund,[21] there is no direct guidance, which has led to a varied practice. Strictly speaking, the "other party" to an investment advisory contract for a fund is the fund itself, while the underlying investors are merely equity holders in such "other party."

– Fund Consents

Some practitioners believe that only the fund, acting through its governing authority (*e.g.*, its general partner, managing member, or board of directors) is required to give consent to an assignment. That view has support from the wording of Section 205(a)(2) of the Advisers Act which, as noted above, speaks of consent of the "other party" to the investment advisory contract (*i.e.*, the fund) and has some limited support in recent case law.

Goldstein v. SEC[22] held that for purposes of the Advisers Act the word "client" is not synonymous with the word "investor," but instead refers to the relevant fund.[23] The Court noted that because the Advisers Act repeatedly made reference to "clients," "the kind of fiduciary relationship the [Advisers] Act was designed to regulate" was between a client (*i.e.*, a fund and not each individual investor) and an investment adviser.[24]

Although *Goldstein* addressed a different section of the Advisers Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act has since deleted the provision at issue in that case, the opinion has still been extended by some practitioners to conclude that only fund consents and not investor consents are required for assignments.

– Underlying Investor Consents

Many practitioners prefer obtaining the consent of underlying investors. They are influenced not only by the absence of direct guidance but also by concerns raised by the conflict of interests present in obtaining the consent from a fund's governing authority. If the fund's decision making is effectively controlled by the adviser, seeking only the fund's consent could be viewed as not meaningfully different from seeking the investment adviser's consent to its own change in control.

Not only may the "tainted" consent be invalid for purposes of the Advisers Act, investment advisers are concerned that failing to seek a truly independent consent could run afoul of the investment adviser's "affirmative duty of utmost good faith"[25] and its duties as a fiduciary. Even if the investment adviser is inclined to adapt *Goldstein* to permit it to grant consent on behalf of the fund, the investment adviser's determination could be second-guessed. If fund performance deteriorates and investors seek redress, the conflict of interest could be used to challenge the validity of the consent.

Many take the position that, for offshore funds with truly independent directors (not affiliated with or having significant commercial relationships with the investment adviser), the conflicts issue is ameliorated and, therefore, consent may be sought from the independent directors.[26] These independent directors frequently retain their own counsel, seek complete background information on the acquirer, interview the acquirer directly, and otherwise undertake a protracted process akin to that which would be conducted by the boards of directors of mutual funds.

Where actual investor consent is sought (and where individual investors will not be afforded the right to withdraw or redeem), advisers may seek consent through the approval of a majority or super-majority of the underlying fund investors by interest (excluding interests owned by the investment adviser and its affiliates). To determine the necessary percentage threshold, practitioners often look to the terms of the fund's governing documents for guidance. Inasmuch as fund documents have not customarily addressed any details of the consent process, practitioners frequently rely on the amendment provisions in the organizational and governing documents of the fund. The logic is that the investors have already agreed to permit a joint vote to change other material elements of their investment, so approving a change in control should follow the same approach and be subject to similar percentage thresholds.[27]

Affirmative Versus Negative Consent

Generally, there are two types of consent to an assignment: "affirmative" and "negative." The affirmative consent process generally consists of the investment adviser sending notice to underlying investors, informing them of the pending transaction and requesting that each investor returns a written consent to the investment adviser.

Obtaining affirmative consents may prove logistically difficult, since investors may ignore consent requests, and the timing of the transaction may not allow for enough time to interact with investors to encourage them to take action and return affirmative consents.[28] Noting the practical difficulties with obtaining affirmative consents, the SEC has endorsed a "negative" consent process with respect to managed accounts.[29]

Negative consents generally operate in the same fashion as affirmative consents, except that inaction on the part of an investor is deemed to constitute consent. Under this approach, the investment adviser first provides notice to its investors of the proposed transaction and requests consent under an affirmative consent process. If the investor does not respond to the notice within a set period of time (*e.g.*, 60 days in the Jennison No-Action Letter), a second notice is sent in which the investment adviser states that it will continue to provide investment management services unless the investor objects (by withdrawal or termination) within a second set period of time (*e.g.*, 45 days in the Jennison No-Action Letter).[30]

Under another more streamlined (but not SEC-endorsed) negative consent approach, the investment adviser provides only one notice to investors, stating that the investor may terminate the advisory relationship or withdraw capital within a set period of time after receipt of the notice. If the investor has not taken those actions by the end of that time period, the investment adviser is entitled to assume that the silence equals consent.

The negative consent process generally has been premised on the investor failing to terminate the investment advisory contract or withdraw its capital. If the investor has liquidity rights that, as a practical matter, allow it to withdraw from the fund if it does not approve the change in control, then negative consents are the most frequently used method of obtaining consent.

Timing to Allow for Consents

Practitioners should plan for the consent process to take at least four to six weeks. Often, depending on the timing for meetings of the boards of institutional investors, obtaining affirmative consent may take as long as two months or more. As such, it is often beneficial to focus on the consent process during the early stages of a transaction.

If the investment adviser relies on a negative consent process, it is important to bear in mind that the SEC has commented only on consent periods ranging from 45 to 60 days at a minimum. Complying with those minimum consent periods outlined in SEC guidance could provide additional support if investors were to later challenge the consent process.

Nevertheless, a somewhat shorter negative consent process (such as 30 days) frequently is used in practice by analogy to the notice periods for seeking approval of amendments to governing documents. Practitioners normally do not consider there to be any material risk of SEC intervention where investors are adequately informed and have sufficient time to properly consider the matter.

Contractual Considerations

Investment advisory contracts generally provide little guidance on the practical details of consent requirements and the consent process. The only Advisers Act-mandated requirement is that the anti-assignment provision satisfy the nominal requirements of Section 205(a)(2) of the Advisers Act, which results in most investment advisory contracts containing generic provisions that track the wording of that section. Traditionally, fund documents have also been silent as to the manner or process for consent.[31]

In our experience, the vast majority of investment advisory contracts contain a boilerplate anti-assignment provision.[32] In many investment advisory contracts, this provision will explicitly apply to consents to assignment under the Advisers Act. If "*written*" consent is required in the anti-assignment provision and reference is made to the Advisers Act, the investment adviser should, absent a convincing contrary rationale, seek affirmative consent rather than negative consent. If no reference is made to the Advisers Act in the anti-assignment provisions, the investment adviser should still read the investment advisory contract carefully to be certain that the Advisers Act is not incorporated via an interpretation clause or through the disclosure documents. If the anti-assignment provision does not make reference to the Advisers Act and there is no interpretation clause incorporating the Advisers Act, then this provision presumably only addresses actual contractual assignments under state law and not Advisers Act assignments.

It is critical to review all relevant documentation, including the disclosure in placement memoranda and other solicitation/communications materials, before deciding upon the method for obtaining the actual consent. In some cases, investors bargain for special consent rights under side letters or similar agreements. In other cases, the underlying partnership or operating agreements or offering memoranda contain "change in control" provisions that require differing consent requirements than the investment advisory contract.

Consequences of Failure to Obtain Consents

A key issue for the parties to a putative change in control transaction is what happens if consent is not obtained? Transaction documents often provide for a reduction in the purchase price if assets under management or management fee revenue declines significantly due to consent shortfalls. It is unclear how to address non-consenting investors if a transaction is required to close with the consent of less than 100 percent of the investors and redemption rights are not exercisable. Could the adviser orphan the objecting fund or account and effectively, on a basis consistent with the relevant documents, abandon its advisory duties to the client? In order to avoid this issue, practitioners often use the majority or super-majority voting mechanism discussed above, so that opposing investors can be deemed to have consented if the requisite majority consents. If a managed account indicates that it does not consent to the transaction but the managed account investor does not actually indicate an intent to withdraw its investment, the appropriate resolution must be worked out with that investor on a case-by-case basis.

The precise liability theories for completing a change in control transaction without obtaining or soliciting requisite consents and continuing the advisory relationship post transaction have never been tested in court, but a variety of claims are possible.

The investment adviser may be held liable for managing assets without client authorization, at least until the next redemption date following consummation of the transaction. If the investment adviser is held so liable, it could be required to reimburse fees or expense reimbursements, or to return assets, irrespective of any agreed lock-ups or illiquidity. Clients could also claim that the investment adviser should be held strictly liable for losses from the date of the deemed assignment, without regard to how prudently the assets were actually managed during that period.

Finally, as discussed above, investment advisers owe fiduciary duties to their clients. Failure to obtain the necessary consents may, therefore, not only breach agreements but regulatory agencies, including the SEC, may find that the investment adviser breached its fiduciary duties.

While the Advisers Act only regulates registered investment advisers, all investment advisers should take care to review their investment advisory contracts, side letters, and other organizational and governing documents for any direct or indirect consent requirements. The SEC may not take any action if a non-registered investment adviser fails to obtain appropriate consents, but such a failure could still subject the investment adviser to significant contractual liability and potential reputational damage.

Conclusion

Careful attention should be given to analyzing, among other factors, the following matters:

1. Is the investment adviser registered?
2. Does the transaction involve an actual contractual assignment under the governing state law?
3. Does the transaction involve a transfer of voting rights?
4. Is the acquirer obtaining any control over management or the investment process?
5. Do the underlying investment advisory documents mandate the manner in which consents may be sought?

6. Are the investors afforded current withdrawal or redemption rights?
7. Within what time frame do the parties have to work?
8. Is there sufficient liquidity in the investments to provide redemption rights upon a change in control to objecting investors?
9. Do the funds have functioning boards of directors (or an equivalent body) with at least one truly independent member?
10. Even if the current transaction does not involve a change in control, is a change in control contemplated in a later stage in the transaction?

Advisers may also wish to take into account the level of risk the parties to the proposed transaction are willing to accept with regard to the consent process, the benefits of the transaction to investors, investor satisfaction with their investment performance, and any post-transaction changes to any key person duties.

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[1] The alternative asset management industry is considered to be composed of hedge, private equity and venture capital funds, and their investment advisers.

[2] For example, in 2011, Evercore Partners Inc. acquired a 45 percent non-controlling interest in ABS Investment Management, Nuveen Investments, Inc. acquired a 60 percent interest in Gresham Investment Management, Northhill Capital invested in Alpha Strategic, and Caxton Associates Partners acquired a minority interest in Wadhwani Asset Management. In 2010, The Carlyle Group acquired a 55 percent interest in Claren Road Asset Management.

[3] For example, in 2011 Nuveen Investments, Inc. acquired FAF Advisors and Visium Asset Management acquired Catalyst Investment Management. In 2008, Macquarie Capital acquired Craton Capital.

[4] For example, in 2011, Bank of America spun off BAML Capital Partners. In 2010, Morgan Stanley spun off FrontPoint Partners, and Bank of America spun off Ridgemont Equity Partners.

[5] Investor objections can arise from several corners. For instance, investors may disapprove of the acquiring party or the nature of its business. The relationship between the adviser and the acquiring party also could raise issues regarding a conflict of interests if, for example, the acquiring party has brokerage, investment banking, or commercial banking operations that will receive favored treatment from the adviser. In addition, investors may feel that the equity holders of the adviser are cashing out and will no longer be driven to serve the interests of the investors. Finally, if investors recently invested or increased their investments with the manager, they may feel that they should have been told of the potential for the transaction in advance.

[6] The SEC appeared to endorse such a view in several No-Action Letters. *See* SEC No-Action Letter to Am. Century Cos./J.P. Morgan Co. (Dec. 23, 1997) (ACC/JPM No-Action Letter) ("[T]he assignment of a non-investment company advisory contract, without obtaining client consent, could constitute a breach of the advisory contract, but not a violation of Section 205(a)(2)."); *see also* SEC No-Action Letter to JPMorgan Chase/Bear Sterns Asset Management (July 14, 2008) (affirming the interpretation set forth in ACC/JPM No-Action Letter).

[7] Section 206 of the Advisers Act imposes on the investment adviser certain fiduciary duties to the clients, such as a prohibition against fraudulent, deceptive, or manipulative behavior and actions. *See also, e.g.*, Hearings on S. 3580 before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong. 3d. Sess. 253 (1948) (statement of David Schenker, Chief Counsel, Securities and Exchange Commission Investment Trust Study) (describing congressional concern with the "trafficking" of investment advisory contacts). Furthermore, Section 205(a)(3) of the Advisers Act requires that all investment advisory contracts must not fail "to provide, in substance, that the investment adviser, if a partnership, will notify the other party to the contract of any change in the membership of such partnership within a reasonable time after such change." One should also note that certain courts, including the Supreme Court, have opined that investment advisers have fiduciary duties to their investors. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963); *See* SEC v. Treadway, 430 F. Supp. 2d 293, 338 (S.D.N.Y. 2006) (stating that an investment adviser owes the highest fiduciary duties to the shareholders of the funds the investment adviser manages).

[8] "'Assignment' *includes* any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but if the investment adviser is a partnership, no assignment of an investment advisory contract shall be deemed to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more members who, after such admission, shall be only a minority of the members and shall have only a minority interest in the business." Section 202(a)(1) of the Advisers Act.

[9] As the definition of "assignment" under the Advisers Act is inclusive, not exclusive, a change in control can take place without the transfer of equity interests in an investment adviser. Obviously, the sale of an investment advisory contract to another investment adviser (and subsequent delegation of duties and assignment of rights) would trigger the requirement for investor consents. Further, if a third party, through commercial arrangements or otherwise, obtains the effective ability to direct the activities of the investment adviser, a change in control could be deemed to take place. As examples, lending documents with onerous covenants that impact day-to-day activities or the acquisition of an option to purchase controlling interests combined with significant restrictions could require investor consents.

[10] Under the definition of assignment in the Advisers Act, some transactions that do not entail the assignment of an investment advisory contract under state law definition of a contractual assignment could result in an assignment for purposes of the Advisers Act. Similarly, some assignments or partial assignments under state law (such as if the investment adviser only assigns the right to receive the fees payable pursuant to an investment advisory contract to another party) may not trigger consent requirements under the Advisers Act.

[11] The SEC in the ACC/JPM No-Action Letter, among other things, looked to the definition of "control" in the Investment Company Act. ACC/JPM No-Action Letter, *supra* note . In addition, in a No-Action Letter to Templeton Investment Counsel Ltd. the SEC stated that because "assignment" was defined in substantially identical language under the Advisers Act and Investment Company Act, it would be appropriate when interpreting the defined term "assignment" under the Advisers Act to look to corresponding rules under the Investment Company Act. SEC No-Action Letter to Templeton Investment Counsel Ltd. (Jan. 22, 1986). A 25 percent control presumption is found in Section 2(a)(9) of the Investment Company Act, which contains a *rebuttable* presumption that anyone who owns, directly or indirectly, more than 25 percent of the equity interests (whether voting or not voting) of an investment company is presumed to control that company. Correspondingly, the same Section also contains a rebuttable presumption that ownership of up to 25 percent of the equity interests of an investment company is presumed to *not* control that company. That Section goes on to add "any such presumption may be rebutted by evidence. "Although this article does not address all the facets of changes in control under the Investment Company Act, notable differences are that the Investment Company Act provides that investment advisory contracts must terminate upon assignment and provides for a rebuttable presumption regarding "control." Furthermore, Rule 15a-4 of the Investment Company Act allows an investment adviser to continue the advisory relationship with its investment company for 150 days under an interim investment advisory contract after the termination of the previous investment advisory contract if (i) the mutual fund shareholder approval cannot be obtained prior to the consummation of the change in control transaction, and (ii) the fees payable to the investment adviser are not changed. Finally, the consent process is more burdensome under the Investment Company

Act than under the Advisers Act; the Investment Company Act generally requires the approval of both the fund's shareholders (which is obtained via an SEC-reviewed proxy statement) and independent board members.

12 Rule 202(a)(1)-1 states that "[a] transaction which does not result in a change of actual control or management of an investment adviser is not an assignment for purposes of Section 205(a)(2) of the [Advisers] Act."

13 Note that, under the Glossary from Form ADV, the presumption of control begins at 25 percent, whereas under the Investment Company Act it begins at over 25 percent.

14 *See* ACC/JPM No-Action Letter, *supra* note .

15 SEC No-Action Letter to Dean Witter, Discover & Co., Morgan Stanley Group, Inc. (April 18, 1997). Note that although the SEC stated that it would not seek enforcement, investor consent was obtained in this transaction.

16 ACC/JPM No-Action Letter, *supra* note .

17 *Id.*

18 *Id.* It is prudent when relying on this No-Action Letter to structure the transaction and the post-transaction control rights to match as closely as possible those rights granted to JPM in the ACC/JPM transaction to help minimize the potential for regulatory inquiry. In that transaction, the veto rights included, among others, approval rights over: (i) mergers and material acquisitions; (ii) incurring material amounts of debt; (iii) issuing or redeeming equity; (iv) approving an annual budget outside of an expected range; (v) liquidation or voluntary bankruptcy; (vi) material contracts; (vii) affiliate transactions; (viii) dividends; (ix) firing senior officers; (x) materially changing compensation policies or accounting, tax, or legal compliance policies; (xi) selection of replacement independent auditors, (xii) entry into new lines of business; and (xiii) amendments to the charter and bylaws. Each of these was subject to a set of negotiated exceptions.

19 SEC No-Action Letter to Zurich Insurance Company, Scudder Kemper Investments, Inc. (August 31, 1998). Note that Scudder ultimately sought investor consent.

20 For purposes of this article, a "managed account" is an individual, non-pooled managed account, investment vehicle, or other financial product or structure through which an investment adviser manages a single investor's capital.

21 For purposes of this article, a "fund" is a pooled investment fund, vehicle, or account through which an investment adviser indirectly manages the capital of many investors.

22 Goldstein, v. SEC, 451 F.3d 873 (D.C. Cir. 2006). One should note that the issue in *Goldstein* was the "Hedge Fund Registration Rule," which stated that "[f]or purposes of section 203(b)(3) of the [Advisers] Act, you must count as clients the shareholders, limited partners, members, or beneficiaries. . . of [the] fund." Section 203(b)(3) of the Advisers Act, which was deleted by the Dodd-Frank Wall Street Reform and Consumer Protection Act, exempted registration under the Advisers Act for investment advisers that had less than 15 clients within a 12 month period.

23 Unless the context indicates otherwise, the terms "investor" and "client" are used interchangeably in this article and, for convenience, do not adhere to the distinction indicated by the Court in *Goldstein*.

24 *See Goldstein*, 451 F.3d. at 880.

25 *Capital Gains*, 375 U.S. at 194.

26 Note that some fund administrators provide employees to serve as board members, but many practitioners would not consider those employees to be independent, because the administrator's business relationship with the investment adviser's funds could compromise their employees' judgment.

27 Where governing documents require different percentage thresholds for approving different actions, given the fairly fundamental impact presented by a change in control, practitioners will frequently apply the more stringent super-majority approval requirement. As a practical matter, percentage thresholds often depend on the jurisdiction in which the fund is incorporated or formed. Funds organized in the Cayman Islands (generally formed as exempted limited companies) may require a super-majority (66.67 percent) to amend the fund documents, while funds organized in Delaware (generally formed as limited liability companies or limited partnerships) may only require a simple majority (over 50 percent) to amend the equivalent documents.

28 This is particularly true for institutional investors such as state pensions or university endowments. Boards need to be convened and written consents need to be discussed and voted upon before such consent can be granted, all of which may take significant time.

29 *See, e.g.*, Templeton Investment Counsel No-Action Letter, *supra* note ; SEC No-Action Letter to Jennison Assoc. Capital Corp. (Dec. 2 1985) (Jennison No-Action Letter); SEC No-Action Letter to Scudder, Stevens & Clark (Mar. 18 1985).

30 See Jennison No-Action Letter, supra note .

31 In recent months, we have observed change in control language being introduced into fund documents. Such change in control language sets forth the notice and consent periods as well as the required investor threshold needed to consent to the assignment. In addition to language regarding notice and consent requirements, language regarding long-term lock-up periods has also been observed in such change in control provisions.

Two examples (the first from a hedge fund and the second from a private equity fund) of such change in control language follow:

1. *The General Partner and/or the Manager, as applicable, shall provide each Fund Investor with at least thirty (30) days' prior written notice of its intent to effect a change in control of the General Partner and/or the Manager, as applicable, or an assignment, for purposes of the Advisers Act, of the Management Agreement by the Manager to a Person which is not an Affiliate of the Manager. The Partnership and each Fund Investor shall be deemed to have consented to any such change in control or assignment if such change in control or assignment, as applicable, receives the consent of a Fund Wide Majority in Interest.*

2. *Effective upon the delivery of a [notice of a change in control of the general partner or investment adviser], the Commitment Period shall automatically be suspended. During such suspension period, only Portfolio Investments that are approved by [a committee of limited partners] or required to be made pursuant to legally binding agreements, or for which there shall be approval from a Majority in Interest of the Limited Partners, may be effected. The Commitment Period may be reinstated, and any such suspension of the Commitment Period shall be terminated, if [a committee of limited partners] or a Majority in Interest of the Limited Partners votes to reinstate the Commitment Period. For the avoidance of doubt, if the Commitment Period is not reinstated, and such suspension is not terminated within 90 days after the commencement of the suspension period, the Commitment Period shall permanently terminate and the obligation of Partners to make Capital Contributions for Portfolio Investments shall be terminated except for Portfolio Investments that are approved by [a committee of limited partners] or those that the Partnership is legally committed to make.*

32 Examples of such boilerplate language are: "*This agreement may not be assigned (within the meaning of the Advisers Act)* without *the written consent of the parties*" and "*No party to this Agreement may assign (as defined under the U.S. Investment Advisers Act of 1940, as amended) or delegate, by operation of law or otherwise, all or any portion of its rights, obligations or liabilities under this Agreement without the prior written consent of the other parties to this Agreement.*"

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