

# 16th Annual Private Investment Funds Seminar

## Starting it Up and Keeping it Going: Employment Law, Office Leasing and Estate Planning

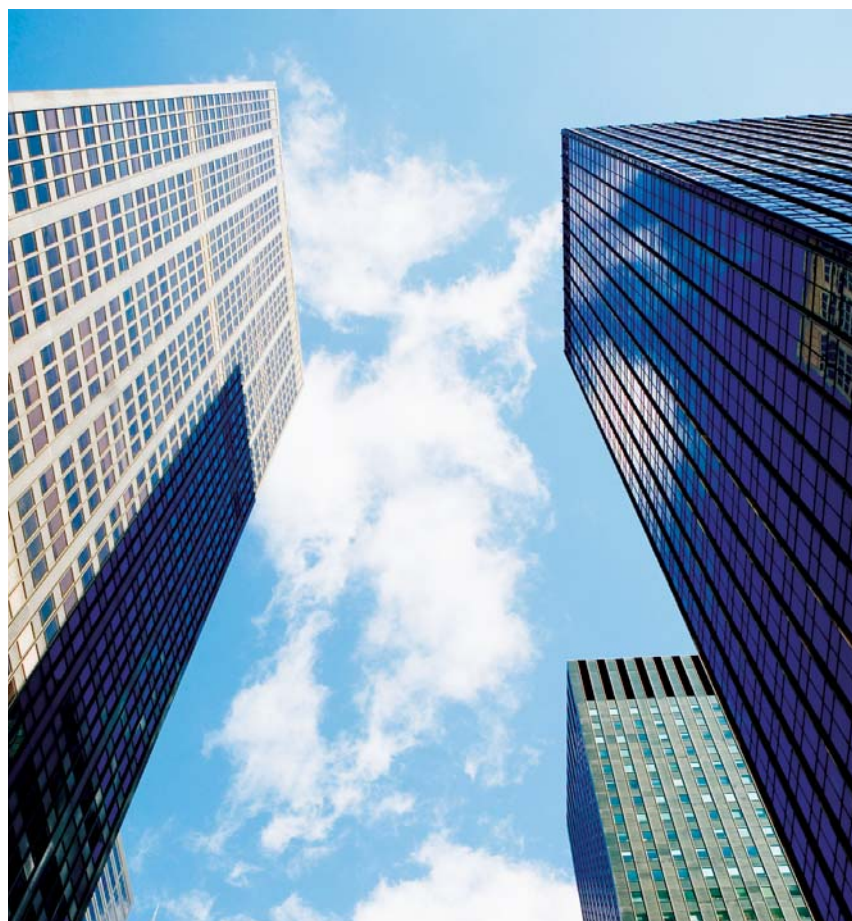
Kim E. Baptiste | Robert S. Nash | Holly H. Weiss

Thursday, January 18, 2007

**I. About the Speakers**

**II. Outlines**

**III. Presentation**



## About the Speakers



## Kim E. Baptiste

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Kim E. Baptiste is a partner in the Individual Client Services Practice Group of Schulte Roth & Zabel LLP in New York. Kim focuses his practice in the areas of estate planning, trusts, charitable foundations, tax planning and estate administration.

Kim is a 1977 graduate of the Boston University School of Law, where he served as note and case editor on the *Boston University Law Review*, and a graduate of New York University School of Law, receiving his LL.M. degree in taxation in 1983. He received his undergraduate degree from Yale University in 1972.

Kim is a Fellow of the American College of Trusts and Estates Counsel and is the author of numerous articles on estate planning, living wills, and probate and administration issues.

## Robert S. Nash

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Robert S. Nash is a partner in the Real Estate Practice Group at Schulte Roth & Zabel LLP. He focuses his practice on commercial leasing (on behalf of both landlords and tenants), real estate development, sales and acquisitions, real estate brokerage and property management, and he has extensive experience negotiating leases on behalf of private investment funds.

Some recent transactions he has handled include:

- Representation of Tishman Speyer, Goldman Sachs and other investors in the simultaneous acquisition of Rockefeller Center and the sale to NBC of 1.5 million sq. ft. of office and studio space
- Representation of Reckson Associates in 420,000 sq. ft. lease to a large law firm
- Representation of CIT Holdings, Inc. in 190,000 sq. ft. lease negotiation
- Representation of Cerberus Partners in 65,000 sq. ft. sublease negotiations
- Representation of The LeFrak Organization in negotiation of 500,000 sq. ft. single lease to Recruit U.S.A., Inc., which was consummated in less than four weeks

Bob is a 1976 graduate of St John's University School of Law, where he served as associate editor of the *St. John's Law Review*. He received his B.A. in 1970 from Bucknell University. He is the past co-chair of the Commercial Leasing Subcommittee of the Association of the Bar of the City of New York and the Commercial Leasing Committee of the New York State Bar Association.

## Holly H. Weiss

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Holly Weiss is a partner in the Employment and Employee Benefits Practice Group at Schulte Roth & Zabel LLP. She represents employers in all aspects of employment law and employee relations including employment discrimination matters, ERISA matters, and issues involving executive compensation and employment agreements, non-competition agreements and other post-employment restrictions and related litigation. Holly successfully defended an employer at trial in the Southern District of New York in a case in which the plaintiff claimed his employment was terminated in violation of ERISA.

Holly is a 1991 graduate of the University of Virginia School of Law. She graduated, *with highest honors*, Phi Beta Kappa, from Emory University in 1987. She is a member of the New York State Bar Association Labor and Employment Law Section's Individual Rights and Responsibilities Committee and Alternative Dispute Resolution Committee. She has authored numerous articles on employment and employee benefits-related matters and is a frequent speaker at industry and professional development seminars, including presentations for the NASD Institute for Professional Development, the New York County Lawyers Association, the New York University Center for Labor and Employment Law and the Institute for Federal Judges at New York University.

# Outlines



## Starting it Up and Keeping it Going: Office Leasing

Robert S. Nash

January 18, 2007

### 1) Analyzing your needs - Identifying the Issues

#### i) Location and Size of Space

- (a) Considerations include whether you need to impress investors, personnel growth projections, technical needs and COST.
- (b) Midtown Plaza District (roughly from 50th to 59th, from Park Avenue to Avenue of the Americas) is most desirable, has lowest vacancy rates and is most costly.
- (c) Rent cost versus capital cost (construction costs will run from \$80-\$250 per square foot).
- (d) Rentable Square Footage (different from "usable" square footage) commonly involves a 25-30% "loss factor."
- (e) Rental cost:
  - 1. Midtown Plaza District - \$90 - \$150 per RSF
  - 2. Midtown generally - \$65 - \$90 per RSF
  - 3. Downtown - \$35 - \$65 per RSF

#### ii) Length of Term

- (a) Short term (3 - 5 years) - Provides flexibility, but offers fewer landlord concessions (free rent and construction money) and exposes the tenant to market rental increases.
- (b) Longer term risks - May be offset if quality of real estate is strong. Fund growth usually easily justifies real estate costs.
- (c) Sublease - Seek constructed space another fund has outgrown, or has leased and constructed for its future growth.
- (d) Incubation Space - Some prime brokers (PBs) and even some private funds lease, construct and equip space to cultivate new funds.
  - 1. Some PBs even rent spaces and give fund clients use of the space.
  - 2. Note recent investigations into possible conflicts of interest (see pg 1., *The New York Times*, Jan. 2, 2007).

### iii) Required Facilities

- (a) Electrical Power - Most offices offer 4 watts PSF (Usable), many funds need 6 - 10 watts.
- (b) Computer Facilities
- (c) Supplementary Air Conditioning
  - 1. For overtime hours of your operation - foreign markets, etc.
  - 2. For server room (needs AC 24/7/365).
  - 3. Adds cost, requires additional electric power.
- (d) Telecommunications Providers, Rooftop Satellite Dish
- (e) Emergency Generators UPS (Uninterrupted Power Source)
- (f) Fitness Center, Food Service, Private Lavatories, etc.

### iv) Who should be the Tenant?

- (a) Management Company - earns fees from invested funds, has few if any assets and little or no "net worth."
- (b) Security Deposits
  - 1. Management entity will be seen as a weak credit, no matter how much money is being managed.
  - 2. Landlords expect security deposits, with the amount determined by several factors (including real estate market).
    - i. Landlord's up-front costs for brokerage fees (32% of one year's rent on a 10-year lease), free rent and construction contribution. These totals often exceed 12 months rent.
    - ii. Years in business - LLs see a threshold after five years.
    - iii. Amount of tenant's investment in office improvements.
  - 3. Cash or letter of credit.
  - 4. Personal guaranties from fund principals.
  - 5. Good guy guaranty.

## 2) Critical Lease Issues

- (a) Limited Liability Entity as Tenant.
- (b) Corporate Flexibility - Typical assignment/sublet provisions severely limit tenant's ability to sell all or even partial interests in the business without first obtaining the landlord's consent.

- (c) Exit Strategy - Tenant should have rights to sublet or assign the lease if the space becomes too small, or too large. Many leases have rather devious provisions to make assignment or subletting nearly impossible.
  - 1. Limiting tenant's liability to a security deposit has practical effect of allowing tenant to walk away from lease losing only it's security deposit.
  - 2. The nature of investment fund business gives fund manager a very low tolerance for law suits.
- (d) Detailed Descriptions of Construction Work To Be Performed by Landlord.
- (e) Renewal Options/Expansion Options.
- (f) Desk User Space.
- (g) Hidden Profit Centers - Extra charges for electricity, overtime AC, water for supplemental AC, cleaning.

### **3) Where to Obtain Expertise**

- (a) Prime Broker
  - 1. To cultivate business, PBs (e.g. Goldman, Morgan Stanley, Bear Sterns, UBS) have groups set up specifically to offer advice and tech support re computer, telecommunications, personnel and space requirements. A fund can also obtain recommendations for brokers, architects and contractors.
  - 2. Advantages - No up-front cost, but advice will be generic and without real accountability for poor advice.
- (b) Real Estate Broker
  - 1. As part of real estate services (finding appropriate properties and negotiating terms), many brokers offer advice about construction costs, space requirements, electrical needs.
  - 2. Advantages - Again no up-front cost, but what is the broker's true level of expertise, and is advice being colored by broker's self interest?
- (c) Architect and MEP Engineer
  - 1. Architects will create a "program" to show the amounts and types of spaces required based upon the number of employees and their functions. Engineer can precisely determine electrical and HVAC needs.
  - 2. Advantages - Objective and technically knowledgeable, and truly responsible, but fee based (often before tenant has signed a lease), often overly cautious ("CYA" can result in impractical advice).
- (d) Attorney
  - 1. Advantages - Too many to list here.

### **4) Common Mistakes to Avoid**

- (a) Working with multiple real estate brokers.

1. New York law gives brokers the right to sue for commissions without a contract, and without substantial involvement in the negotiation of the lease.
2. Select a broker early on, and base the selection on references and the broker's documented expertise with your particular market segment.
3. Expect a wider range of skill and integrity than you are accustomed to, but some are truly dedicated to your welfare, and are tremendously knowledgeable about the marketplace.

(b) Waiting too long to assemble your real estate "team."

1. Consists of an experienced real estate leasing attorney, broker, architect, MEP engineer, and, for larger construction projects, a construction consultant or owner's rep.
2. Each can provide valuable information to inform the lease negotiation and save the tenant from costly mistakes and delays.
3. Tenants may be reluctant to incur fees before a lease is signed, but consultants can add value when engaged at an early stage.

(c) Relying upon verbal commitments from a landlord concerning construction costs and delivery dates.

## Starting It Up and Keeping It Going: Employment Law

Holly H. Weiss

January 18, 2007

### 1) Getting Started as a New York Employer

Employers in New York are required to comply with many statutes, even if they employ only one employee. For example, New York employers must:

- a) register with New York State Unemployment Insurance;
- b) obtain Workers' Compensation and Disability Insurance;
- c) comply with IRS withholding and reporting requirements;
- d) comply with posting requirements (e.g., USERRA, EEO, FLSA);
- e) comply with new-hire reporting requirements;
- f) comply with the Immigration Reform and Control Act (IRCA);
- g) comply with federal and state wage and hour laws (including overtime provisions); and
- h) comply with federal and/or state laws (i) regarding employees and/or applicants who are subject to military service, who serve on juries, who need time to vote, who engage in lawful recreational activities, and who have criminal records and (ii) prohibiting race discrimination (Section 1981) and sex discrimination in pay (Equal Pay Act).

As employers grow, the statutory requirements grow. For example, the following statutes become applicable at the employment levels set forth below:

Statute	Subject Matter	Enforced By	Covered Employers
New York State Human Rights Law	Discrimination (sex, age, race, etc.)	New York State Human Rights Commission	4 or more employees
New York City Human Rights Law	Discrimination (sex, age, race, etc.)	New York City Commission on Human Rights	4 or more employees
OSHA	Workplace safety	Department of Labor (DOL)	10 or more employees
Title VII	Discrimination (sex, race, national origin, ethnicity)	Equal Employment Opportunity Commission (EEOC)	15 or more employees
Americans with Disabilities Act	Disability discrimination	EEOC	15 or more employees

Pregnancy Discrimination Act	Pregnancy discrimination	EEOC	15 or more employees
Age Discrimination in Employment Act	Age discrimination	EEOC	20 or more employees
COBRA	Continuation of health care coverage	DOL (PBGC)	20 or more employees
Family and Medical Leave Act	Leaves of absence	DOL	50 or more employees
WARN	Requires notice of mass layoffs	—	100 or more employees
ERISA	Employee benefit plans	DOL (PBGC)	Generally, 100 or more employees

## 2) Hiring Employees

### a) Recruitment and Interviewing

- i) **Advertising.** When developing advertisements and other recruitment methods, employers should make sure there is no listed preference for any protected classification (e.g., race, ethnicity, sex, or age). Do not advertise a search for "recent grads," for example.
- ii) **Employment Applications.** Employment applications should not imply that the employer is screening applicants based on race, ethnicity, sex, age, or other protected classification. Applications should confirm that employment is at-will and should require a signature by the applicant attesting to truthfulness.
- iii) **Interviewing.**
  - (1) Interviewers should not make promises to applicants regarding job security, compensation, and duration of employment, unless the employer intends to be bound by such promises.
  - (2) Interviewers should not ask, directly or indirectly, for information about a job applicant's legally protected characteristics or activities.
- iv) **Background Checks.** Employers should comply with federal and applicable state laws governing background checks. Among other things, such laws require employers to obtain written authorization from a job applicant *before* obtaining information about the job applicant from a third party, and require employers to provide certain notices when they take action based on information received.

### b) Classifying and Paying Workers

- i) **Employee v. Independent Contractor.** Employers should properly classify workers as employees (who are subject to applicable tax withholdings) and independent contractors (who are responsible for their own taxes). Misclassification can result in a number of adverse consequences to the employer.
- ii) **Exempt v. Non-Exempt.** Employers should properly classify employees as exempt (not eligible for overtime) or non-exempt (eligible for overtime). That an employee receives salary—even a high salary—is not determinative. The employee's duties must also be

considered. Improperly classifying employees can result in a number of adverse consequences to the employer.

- iii) **Timing of and Deductions From Wages.** Employers should comply with applicable state law governing the timing of payment of wages. (Some states require payments at least twice a month, for example.) Employers should also comply with laws regarding permissible deductions from wages.

c) **Written Employment Arrangements**

With the exception of certain employer-wide policies (e.g., vacation), there is no legal requirement that the terms and conditions of employment be in writing. However, documenting the terms and conditions of employment may, among other things, be needed to recruit top talent, and may lessen the likelihood of a future employment dispute.

- i) **Offer Letters.** An offer letter sets forth the terms and conditions of employment, but does not usually set a durational term or alter the at-will employment relationship. Typical provisions in offer letters include:
  - (1) start-date, title, reporting;
  - (2) compensation and benefits (e.g., base salary, bonus opportunity);
  - (3) confirmation of at-will employment status;
  - (4) payments to be made upon termination of employment (or confirmation that no payments will be made);
  - (5) important employment obligations (e.g., confidentiality, compliance with employer's policies); and
  - (6) conditions to commencing employment (e.g., subject to background check, drug-testing).
- ii) **Employment Agreements.** Employment agreements are typically used for senior, highly compensated employees, and contain mutual obligations. They differ from offer letters in that they usually contain a durational term of employment, and provide for severance upon termination of employment under certain conditions (e.g., without cause termination, good reason termination, death or disability). Typical provisions include:
  - (1) effective date, title, duties, reporting;
  - (2) compensation and benefits;
  - (3) termination provisions, including definitions of cause, good reason, etc., and severance;
  - (4) restrictions on use and disclosure of confidential information, trade secrets, employer property and work product;
  - (5) restrictions on competition and solicitation of employees and customers, clients and/or investors;
  - (6) representations and warranties (e.g., that the employee is free to work for the employer); and
  - (7) dispute resolution mechanisms.
- iii) **Confidentiality Agreements.** Prudent employers require all employees to execute confidentiality agreements to protect the employer's confidential and proprietary information.

Such agreements may be within employment agreements, set forth in countersigned offer letters, or in separate agreements.

- iv) **Non-compete agreements.** Non-compete agreements are usually contained within employment agreements. Non-compete agreements are generally enforced only when they are reasonable and narrowly tailored to protect only the employer's legitimate business interests. To determine the validity of a non-compete agreement, courts will examine whether the terms of the agreement are reasonable. Reasonableness is measured by factors such as the scope of the geographic restriction, the duration of the agreement, the type of activity restricted, the hardship on the employee and the effect on the general public. The longer the duration and the larger the geographic territory, the more likely a court could find such terms as overbroad and contrary to public policy and, therefore, unenforceable. Note that state law governs the enforceability of restrictive covenants; some states prohibit them.
- v) **Non-solicitation agreements.** Non-solicitation agreements are usually contained within employment agreements. A non-solicitation agreement often prohibits an employee or former employee from soliciting other employees of the employer for certain periods of time. Non-solicitation agreements are also used to prohibit the solicitation of clients, customers or investors during employment and for a period after termination of employment.

### 3) Employee Benefit Plans

- a) Health insurance (required to be competitive).
- b) Disability insurance (required by state law).
- c) Retirement plan (401(k) plan is a market standard).

### 4) Employer Policies

#### a) Handbooks

##### i) The Benefits of Having a Handbook.

- (1) An employee handbook defines and communicates employer standards and expectations. Handbooks allow employers to treat employees in a consistent manner over time, thereby limiting exposure to discrimination claims.
- (2) An employee handbook allows an employer to share its policies in a format that is easy to disseminate to the workforce.
- (3) An employee handbook can serve to further an employer's corporate culture.

##### ii) Handbook Contents.

- (1) All handbooks should contain EEO, anti-discrimination and anti-harassment policies (with reporting procedures).
- (2) Handbooks typically contain policies concerning: employee classifications; promotions; hours; overtime; payroll period and payday; paychecks; performance evaluations; discipline procedures; resignation and termination procedures; benefits; vacations; holidays; sick and personal days; leaves of absence; jury duty; bereavement leave; dress code; telephone use; electronic communications (e-mail, blogs, etc); workers compensation; safety; and smoking.
- (3) Handbooks should include an "employment at will" statement, a disclaimer stating that the handbook is not a contract, a reservation of rights for the employer to amend or

terminate the policies in the handbook, and a verification page (acknowledging receipt and understanding of handbook).

b) **Discrimination and Harassment.**

- i) Regardless of whether the employer has a handbook, all employers subject to anti-discrimination statutes (e.g., any employer with four or more employees in New York) should disseminate an anti-discrimination and anti-harassment policy, which contains, among other things, clear reporting procedures. Having a policy will lessen the likelihood of employer liability in employment discrimination litigation.
- ii) Employees, particularly managers, should be trained with respect to the employer's anti-discrimination and anti-harassment policy. Providing training will lessen the likelihood of unlawful activity occurring in the workplace and of employer liability in employment discrimination litigation. Some states mandate training. Connecticut, for example, requires that all employers with 50 or more employees provide 2 hours of sexual harassment training to all supervisory employees within 6 months of the assumption of a supervisory position.
- iii) The employer's anti-discrimination and anti-harassment policy should be re-distributed regularly.

**5) Performance Reviews and Terminations**

- a) **Performance.** Employers should develop consistent procedures to evaluate employee job performance. Differential treatment of similarly situated employees leads to allegations of discrimination.
- b) **Termination.**
  - i) **Releases.** If the employer is providing discretionary severance, or other discretionary benefit as a result of a termination, the employer generally should obtain a release of claims. Counsel should be consulted regarding the terms of a release agreement.
  - ii) **References.** Employers should tread carefully when giving employment references for former employees. Statements beyond confirming dates of employment and title could open the employer up to defamation claims, and are restricted in some states by statute (e.g., Connecticut).

## Estate Planning for Hedge Fund Managers

Kim E. Baptiste

January 18, 2007

### 1) Purpose of Estate Planning

- a) Transferring the future growth on appreciating assets to children now at little or no gift tax cost.
- b) By making such transfers, these assets will not be included in the donor's taxable estate and will avoid being subject to a federal estate tax of 47% plus an additional 8% New York state estate tax.
- c) Difficult to predict how the estate tax will change in the near future.
  - i) Possible scenarios
  - ii) Increase the federal estate tax exemption to \$3.5 million
  - iii) Lower the highest marginal rate of 47%
  - iv) Significant changes are less likely with a Democrat-controlled Congress

### 2) Transfer of Interest in Incentive Fee

- a) A hedge fund manager's asset with the greatest potential for appreciation is the incentive fee or carried interest.
- b) Typically, this consists of an interest in the LLC that serves as the general partner of the domestic fund and a limited partnership interest in the management company that receives the offshore incentive fee.
- c) Need for a vertical slice if the manager decides to transfer a portion of his incentive fee in the domestic fund, he must also transfer the same percentage of his investment capital.

### 3) Transfer to a GRAT

- a) The interest in the incentive fee and capital will be transferred to a special type of trust known as a grantor retained annuity trust (GRAT).
- b) A GRAT is an irrevocable trust that pays the manager either:
  - i) a fixed annual dollar amount (i.e., the annuity) for a specified number of years, or
  - ii) an escalating annuity that increases by 20% each year during the specified annuity term.
- c) The annuity is typically expressed as a percentage of the value of the property transferred to the GRAT (i.e., the incentive fee and investment capital) as finally determined for federal gift tax purposes.
- d) If the manager survives the specified term, any property left in the GRAT after the term will be excluded from his or her taxable estate.

- e) For gift tax purposes, the manager is treated as making a taxable gift of the difference between the value of the property he contributed to the GRAT and the present value of the annuity interest he retained.
- f) By tailoring the size of the annuity and the length of the GRAT term, the gift can be zeroed out so that under no circumstances will a taxable gift ever result.
- g) The estate planning benefit of a GRAT will be achieved if the assets in the GRAT appreciate more than the IRS assumes assets will grow at the beginning of the GRAT term; today that rate is 5.8%.
- h) If the assets do appreciate more than the IRS's assumed rate, there will be something left in the GRAT at the end of the annuity term, and such property will pass to a trust for the manager's spouse and children.
- i) In the hedge fund manager context, this means that after the GRAT term, the successor trust, which will no longer be includable in the manager's taxable estate, will continue to own an interest in the fund's incentive fees. However, the GRAT will no longer be required to pay the manager anything more.
- j) In essence, the GRAT is like a loan that is fully amortized over the GRAT term. This means that the manager will receive back from the GRAT the full value of what he contributed to the GRAT (i.e., the incentive fees and investment capital) plus a coupon of 5.8%.
- k) The GRAT is also a grantor trust, which means that the manager will continue to pay the income tax on any income earned by the trust. By paying this tax, the manager is essentially making an additional tax free gift of the amount of the tax.

#### **4) Valuation**

- a) The success of the GRAT will depend on two variables: the performance of the incentive fee and the initial valuation of the property contributed to the GRAT (i.e., the incentive fee and the investment capital).
- b) Because the annuity is based on the initial value of the GRAT property, the lower the initial value, the lower the annuity and the more that will be left in the GRAT for the manager's family outside of the manager's estate.

#### **5) Payment of the Annuity**

- a) The GRAT must pay the manager the required annuity each year; it cannot give the manager a note.
- b) Sources for payment of the annuity:
  - i) Cash received from the incentive allocation
  - ii) Transferring back a portion of the capital that the manager initially contributed to the GRAT
  - iii) Borrowing from a source other than the manager
  - iv) Transferring back a portion of the carried interest in kind
- c) With escalating annuity payments (i.e., 20% each year), the annuity will be considerably lower in the first year than in the last year.
  - i) With a level annuity payment schedule for a 5-year GRAT, the annuity will be 23.6% of the initial value of the trust property.
  - ii) With 20% escalating annuity payments, the first-year payment will be 16.2% of the initial value and the fifth-year payment will be 33.6%.

## **6) Charitable Lead Annuity Trust**

- a) A charitable lead annuity trust (CLAT) is the charitable counterpart to a GRAT: Instead of the annuity being paid to the manager, it is paid to one or more charitable organizations.
- b) The charity may be the manager's private foundation, although the manager will not be able to direct which charities will receive those funds from his foundation.
- c) It is possible to zero-out a CLAT.
- d) The CLAT will not be a grantor trust; instead it will be taxed on whatever income it generates and receives a charitable deduction for the amount it pays to charity each year.

## **7) Dealing with the deferral**

- a) On the death of the manager, any amounts he or she has deferred for income tax purposes will accelerate and be payable to the manager's estate.
- b) The deferred amount will be subject to income tax in the year the estate receives it.
- c) If the manager is survived by a spouse and the manager's estate passes to the spouse, either outright or in a marital trust, there will be no estate tax on the deferral.
- d) If the manager is not survived by a spouse, the entire amount of the deferral will be subject to both estate and income tax, at a combined rate of over 75%. In this case, the manager should consider leaving a bequest in his or her will to charity of some part or all of the deferral.

# Presentation



**SchulteRoth&Zabel**

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and Estate Planning**

**Kim E. Baptiste**

**Robert S. Nash**

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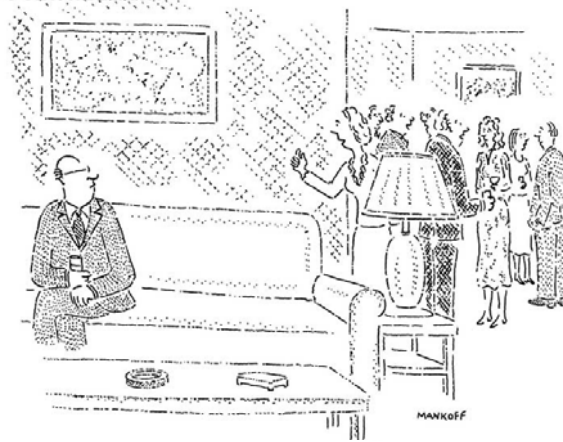
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*"Come with me. I've found someone who'll talk square footage with you."*

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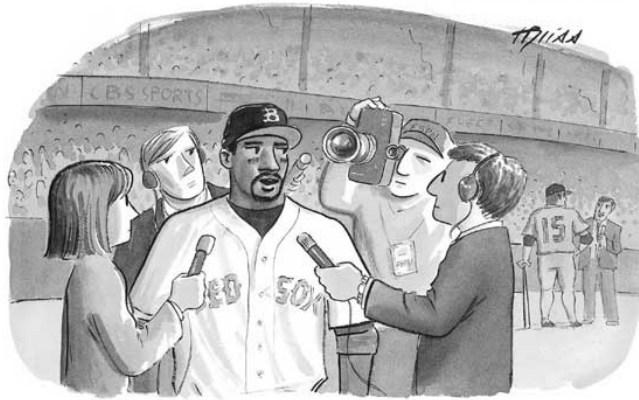
**2007 Private Investment Funds Seminar**



**Starting it Up and Keeping it Going:  
Employment Law**

**Holly H. Weiss**

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*"Hey, I'm just happy to be making an obscene amount of money."*

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*"I see by your résumé that you're a woman."*

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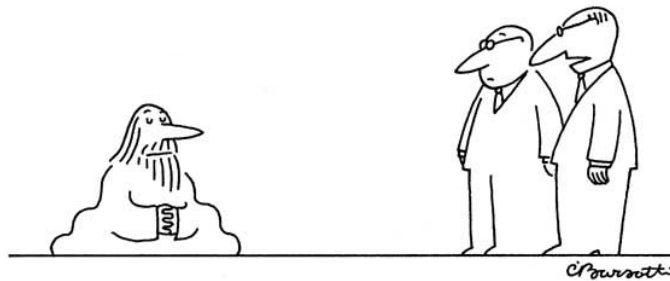
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*"I'm looking to hire a C.F.O. Anyone interested?"*

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*"Did you hire a consultant? I didn't hire a consultant."*

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*"We used to feel your pain, but that's no longer our policy."*

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*"Oh, hiring's O.K., but firing provides a real sense of closure."*

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**2007 Private Investment Funds Seminar**



**Starting it Up and Keeping it Going:  
Estate Planning**

**Kim E. Baptiste**

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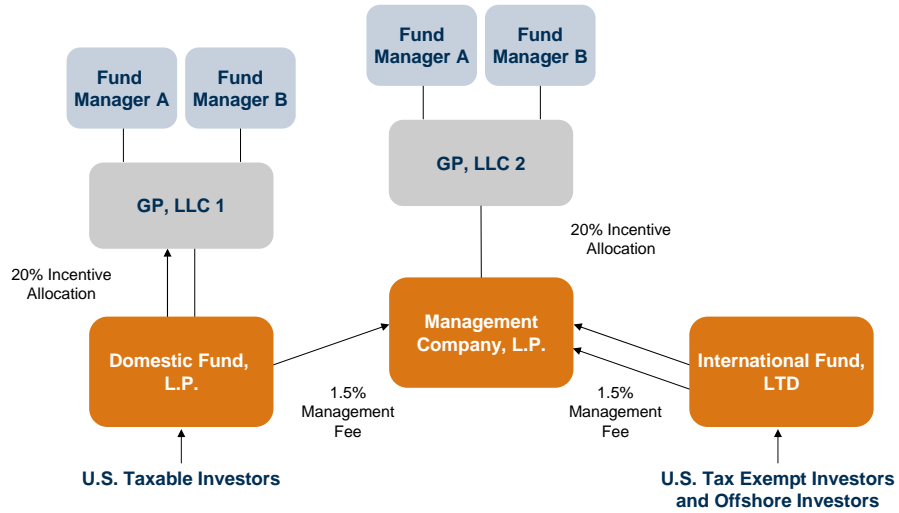


*“Well, we’ve licked taxes—that just leaves death.”*

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## Structure Chart: Pre-GRAT



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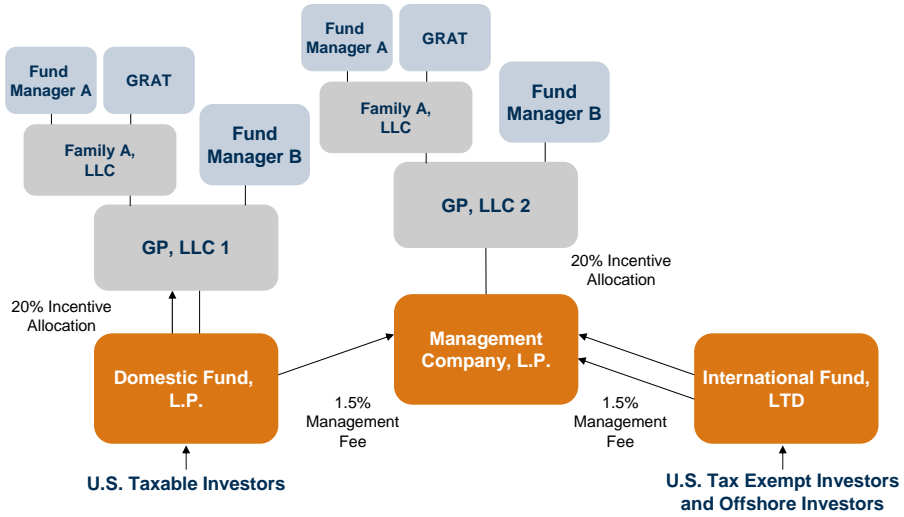


*"I give you a fifty-fifty chance. Pay me up front, and I'll make it sixty-forty."*

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## Structure Chart: Post-GRAT



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*"Someday, you may thank me for breaking what was becoming, in this family, a viscous cycle of inheritance!"*

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