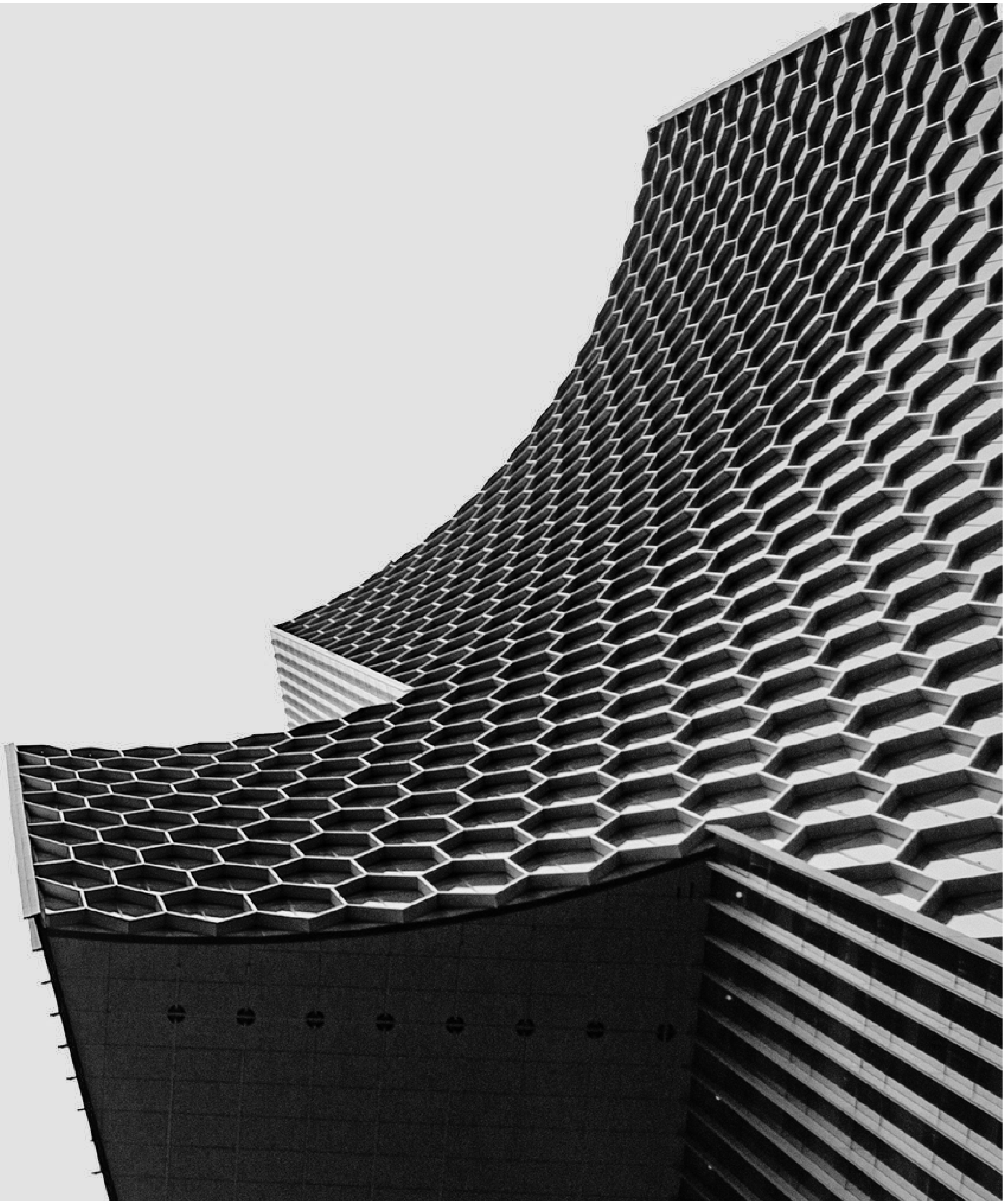
# Best Practices Guide for Private Equity & Venture Capital Funds

September 2022



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APCRI

# What we offer

Cuatrecasas advises on all areas of business law, through highly specialized legal teams with extensive knowledge and experience. We help our clients with the most demanding matters wherever they are based.

**Talent**
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**Experience**
We have a **sectoral approach** and focus on all types of business. With extensive knowledge and experience, we offer our clients the **most sophisticated advice**, covering ongoing and transactional.

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We combine our global scope, through a network of 27 offices in 13 countries, with deep knowledge and local experience in every market where we operate.

**Maximum cover on the Iberian Peninsula**
With offices in the main cities in Spain and Portugal, our local teams combine proximity and local knowledge with the firm's global resources and expertise.

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We have teams in Beijing, Brussels, Casablanca, London, Luanda, Maputo, New York and Shanghai, and a European network with leading law firms in France, Germany and Italy. We have a flexible cooperation model, without exclusivity or obligations, with leading law firms in other countries.

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**CUATRECASAS ESG**

At Cuatrecasas, we incorporate environmental, social and governance (ESG") criteria in our service provision and in our internal management.

Here we describe the main parameters we use to measure our ESG performance. You can also access our Corporate Sustainability Report.

BRONZE 2021 ecovadis Sustainability Rating

# The true value of the union, strength and wisdom of private capital

All entities that carry out, foster or contribute to venture capital investments are qualified to be members of the APCRI, particularly the following:

- Venture capital companies and investment companies
- Banks, insurance companies and pension fund management companies
- Public institutes, foundations, financial and legal advisors, and individual leaders

The Portuguese Private Equity Association (APCRI) is the organization that represents the private equity and venture capital industry in Portugal. Its mission is to protect the common interests of the entities that pursue venture capital investments in Portugal.

Together, we promote venture capital as one of the drivers required for economic growth, and we contribute to shaping the future in a positive way.

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# Prologue

The Portuguese Private Equity Association ("APCRI," in its Portuguese acronym) aims to (i) continue fulfilling its role as the representative of the general common interests of private equity and venture capital operators in Portugal, and (ii) contribute to disseminating the characteristic good practices of this activity.

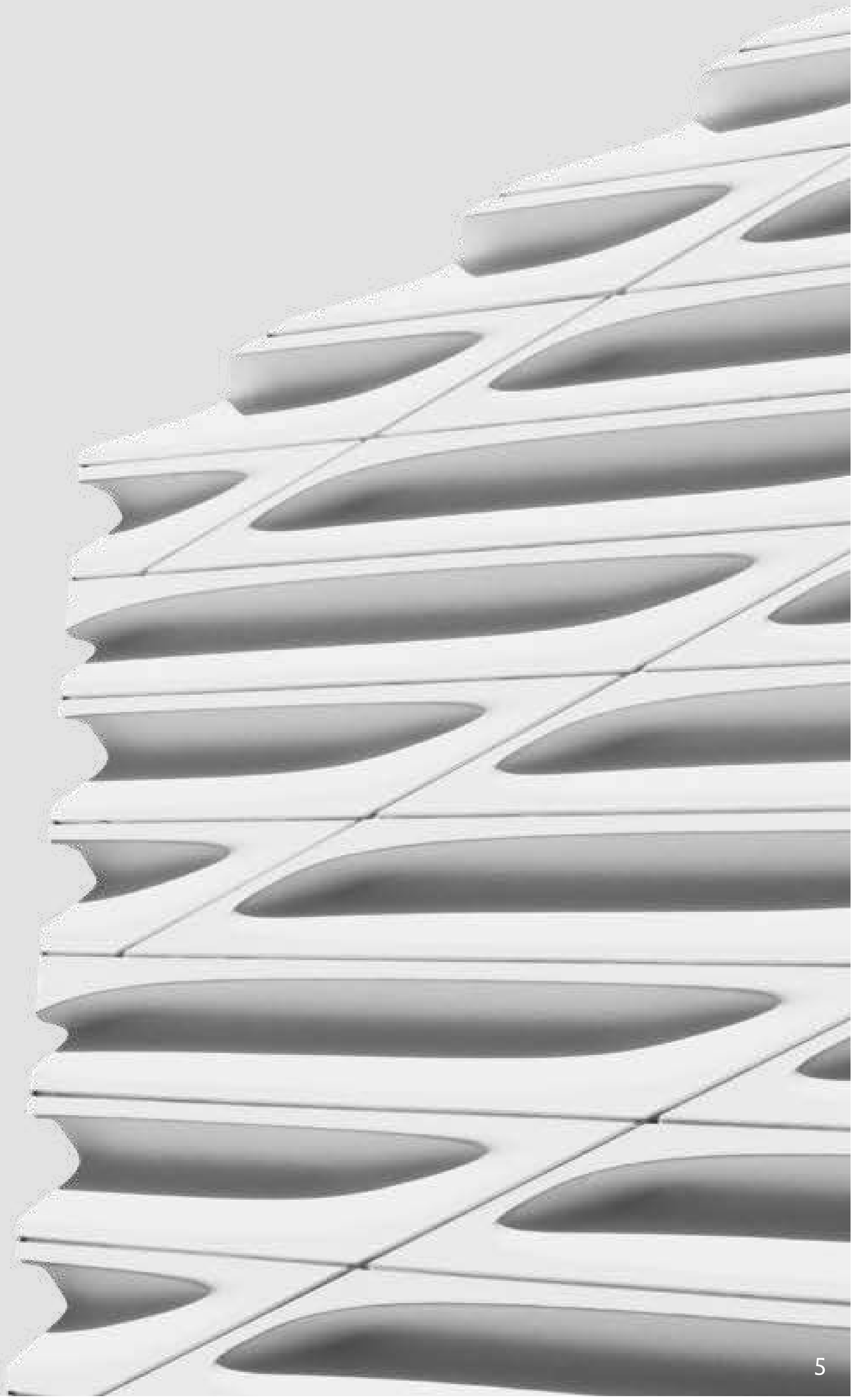
Essentially, the APCRI's three objectives are the following:

1. To keep abreast of all the changes underway—or necessary—to ensure Portugal has a competitive legal, tax and regulatory regime for private equity activity. The reference and benchmark for the dissemination and lobbying work to be carried out in Portugal must be analyzing the evolution taking place in the most advanced countries, always in line with Invest Europe's legal/regulatory and tax committees.

2. To promote the creation and dissemination of information about the sector in Portugal and in Europe, particularly on statistical and activity performance, as well as the dissemination of industry standards, always in line with the Invest Europe structure.

3. To focus on the training of professionals already working in the sector, while also promoting events, particularly those that may have greater impact. It must also incentivize the creation of information and studies and, above all, promote their dissemination if they are useful or necessary for the performance of private equity and venture capital operators, affording greater exposure to this activity in the country, always in line with the Invest Europe structure.

In this respect, this Best Practices Guide for our sector contributes to its dissemination and sustainable growth objectives. Therefore, we are delighted to join this initiative, which we think will help the Portuguese economy grow with the participation of the private equity sector that the ACPRI represents.



# Introduction

Private equity and venture capital funds - in their multiple forms - have a vocation for medium and long-term investment. It is essential that a relationship based on trust, transparency and a balance of interests exists between investors and the management team in order to provide stability to these funds and so they can fulfill their investment strategy.

In this respect, structures subject to principles of good governance allow the alignment of all the interests underlying the private equity and venture capital funds. To create those structures, it is essential to implement a series of measures that can prevent and manage situations that may give rise to conflicts of interest among the various parties involved.

Principles of good governance allow the alignment of all the interests underlying the private equity and venture capital funds

# Introduction

This Guide presents a set of best practices and proposals for action based on the following principles, each of which are treated separately in this document:

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Alignment of interests
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Deal Structuring and Investment Strategy
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These principles shall be considered during the whole life of the venture capital and private equity fund, from the fundraising process and the creation and investment of assets to their divestment and the dissolution and winding up of the funds.

These principles are not in any case intended to replace or limit the potential negotiating capacity of managers and investors in relation to the design and definition of the governance of the corresponding firms.

This Guide has been prepared based on applicable Portuguese and European regulations and on the best practices recommended by the Institutional Limited Partners Association (ILPA).

Hereinafter, each venture capital and private equity entity will be referred to as "**Fund**"; the management team (or, in general terms, the company managing the Fund) will be referred to as the "**GP**" or "**Manager**" and the Fund unitholders or shareholders will be referred to as the "**LP**" or "**Investors**".

Block I

# Alignment of interests

Block I | Alignment of interests

# 1. GP's Commitment

## Relevant aspects

## Applicable best practices

1.1. The GP shall devote a certain amount of time to the Fund, the predecessor and successor funds that represents a substantial part of their business activities. This material time dedication to the Fund may be provided for in the LPA.

For this, the annual report of the Fund must list, at least generally, other Funds management activities carried out by the GP during the year.

1.2. The LPA should clearly establish under what circumstances the setting up, marketing and investment period of a successor fund can be undertaken, as well as the rules of coexistence between the Fund and the successor fund.

It should also describe to what extent the setting up of the successor fund affects the Fund management fee received by the GP.

However, it is recommended that the GP does not set up a successor fund, particularly one with similar target investments, until the end of the investment period of the relevant Fund, or until the capital of the relevant Fund has been substantially invested, generally in a specific percentage foreseen in the LPA.

1.3. The LPA should provide for the GP's personal commitment and its manager to invest in the Fund, either directly or indirectly, in equivalent conditions to the rest of the Investors (pari passu) or in other specific conditions as provided in the LPA, namely, the investment by the GP in the Fund may have different economic rights granted to this (e.g., the right to receive distributions on other terms, success fee carried interests, reduction in or exemption from the payment of the management fee, etc.).

1.4. The LPA is expected to establish the minimum investment commitment by the EG.

# 2. Term of the Fund

## Relevant aspects

## Applicable best practices

2.1. The Manager shall ensure that the period for attracting investors finishes in a reasonable time after the first closing, which shall be determined in the LPA (e.g. the Final Closing).

2.2. To maintain equal investor treatment and conditions, investors committed to investing in the Fund usually pay an equalization fee or interest after the first closing and until the final closing. This fee is usually equal to the preferred rate of return calculated for the period between the first closing and the entry of the investor.

2.3. The possibility of establishing an equalization fee is considered as compensation for Investors that entered in previous closings of the Fund, as with their contributions they would have financed the first disbursements of the Fund, thus benefiting later Investors.

2.4. If there are any exceptions to the payment of equalization fees for certain Investors, the objective conditions that must be met by such Investors in order to benefit from said exceptions should be provided for in the LPA.

2.5. For the purposes of calculating the internal rate of return (IRR) of the Fund, Investors who have entered in subsequent closings will be deemed to have been admitted at the first closing of the Fund.

2.6. The term of the Fund may be extended provided those extensions are approved by the majority of the Investors (in the relevant unitholders meeting), under proposal from the GP. In any case, the LPA should provide for a maximum time limit for the extensions, which may not exceed the initial duration, pursuant to Portuguese law.

2.7. If the extension of the term of the Fund is not approved, the GP shall proceed to winding up the Fund under the terms provided for in the LPA, providing the Investor with information on the conditions in which said winding up will be carried out.

2.8. If the GP considers extending the life of the Fund, it must provide the Investors with clear information on the reasons for such extension, the conditions in which this will be carried out (including its economic terms, such as possible reductions in the management fee), and the mechanisms for approving the extension provided in the LPA.

Block I | Alignment of interests

# 3. Management fee

## Relevant aspects

## Applicable best practices

3.1. The LPA shall clearly provide the terms of the management fee, including its amount, its basis of accrual and payment.

3.2. The LPA should also foresee the calculation basis for the management fee.

3.3. At the end of the investment period, or any other reasonable period established in the LPA, the possibility of modifying the calculation basis for the management fee according to other possible formulas should be assessed, without prejudice to the fact that, in such a case, the most reasonable measure is for that basis to become the capital invested by the Fund. If the calculation basis becomes the invested capital, that basis must be reduced by the amount of the corresponding divestments made or investments that have been written off.

3.4. The management fee shall be in line with a reasonable cost and wages structure for the GP.

3.5. Information on the management fee received (or to be received) by the GP should be included in the regular information sent to the LPs, specifying the basis for calculation.

3.6. A performance-based management fee attributed to the GP may be established in the LPA together or as an alternative to the carried interest mechanism detailed in section 4 below.

# 4. Economic rights of the GP's share in profits (carried interest)

## Relevant aspects

## Applicable best practices

4.1. The LPA must ensure that the economic rights granted to the GP are structured in a balanced way to motivate and encourage the GP and ensure that LPs' interests are protected.

4.2. The GP's share of returns (other than the management fee) should be paid provided the LPs have been first repaid of the amounts of their capital contributions and preferred return (if applicable).

4.3. It is common practice for the LPA to provide that, after the LPs are repaid for their capital contributions and their preferred return, the GP will receive a percentage of return ("catch up") based on the preferred return that the LPs would receive. After the catch up, the GP will also be entitled to the carried interest, which is a percentage of the remaining returns on the Fund.

4.4. The annual reports sent to LPs must detail the total amount accrued in favor of the GP and the amount that must be distributed to LPs and the GP.

4.5. The LPA should regulate the circumstances whereby the GP received any exceeding amounts not according to the LPA, by setting up specific provisions, according to which the GP may be required to return any excess compensation received ("clawback") associated with an escrow account mechanism, where at least part of the compensation to which the GP could be entitled would be deposited for a certain period of time or until the occurrence of a certain event.

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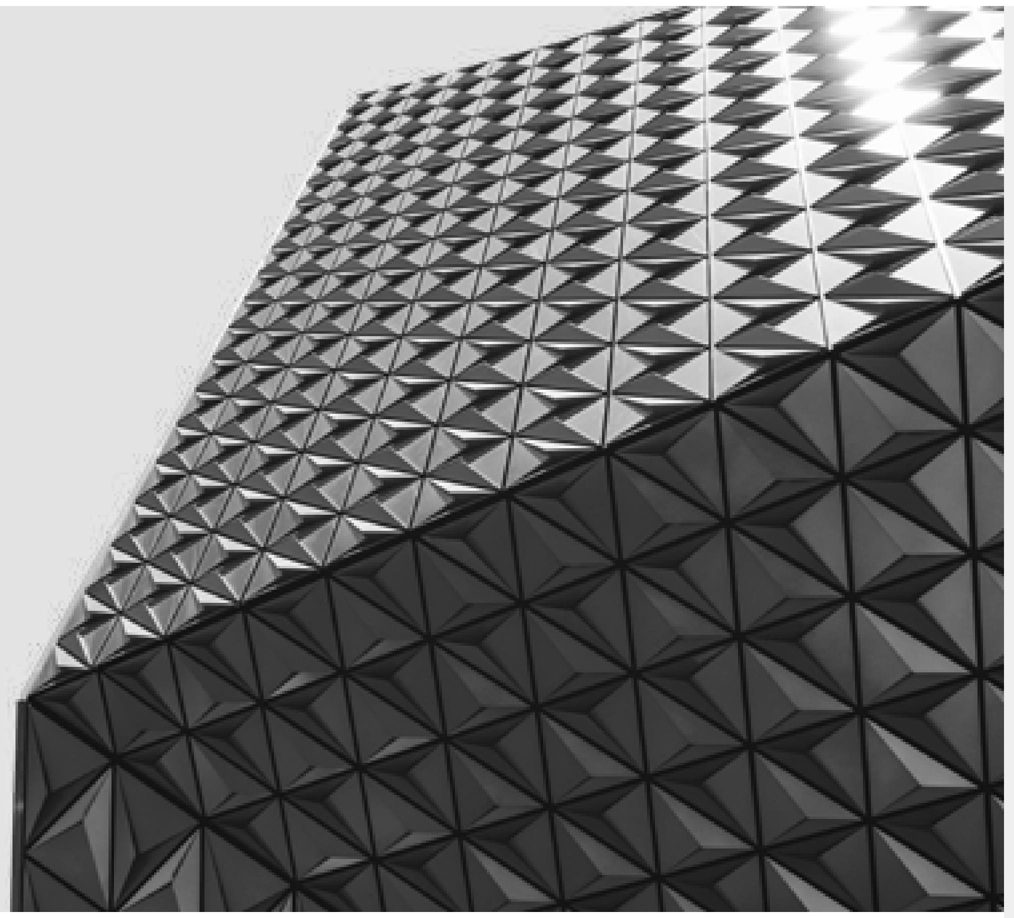


# 5. Reinvestment

## Relevant aspects

## Applicable best practices

5.1. If the retaining of proceeds or the return of amounts previously distributed from the LPs for reinvestment purposes is foreseen (temporary distributions), the LPA should detail upon which conditions such reinvestm ent can be made.

5.2. Moreover, it is highly recommended that such reinvestments are subject to quantitative and time limitations.

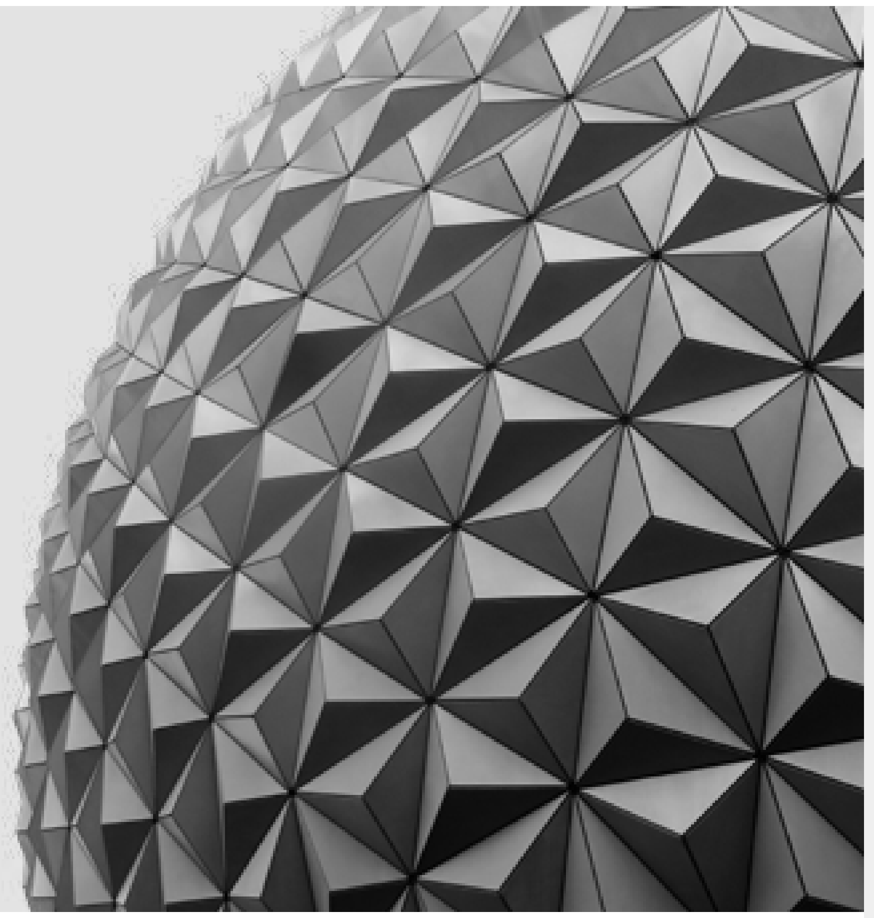
5.3. The standard is that reinvestment cannot exceed the capital invested (the acquisition price) in the asset that gave rise to the income distribution subject to reinvestment.

5.4. The GP should detail in the annual reports how the reinvestment by recalled distributions is in the best interest of investors.

Block I | Alignment of interests

# 6. Earnings from underlying investments

(Investment Related Fees)



## Relevant aspects

## Applicable best practices

6.1. The Investors shall be provided with clear information on the nature and origin of all fees paid directly or indirectly by the Portfolio Companies to the GP or any of its affiliates. These may not be excessive in relation to the size of the Fund and to those companies.

6.2. This type of income must be dealt with in a case-by-case basis, taking into consideration the underlying funds. The LPA should clearly provide about the specific nature of such income and its implications. The annual reports of the Fund should also provide information on this matter.

6.3. Depending on the size of the Fund, it is market practice for the LPA to provide that the GP proceeds resulting from underlying Fund investments (other than management fee, success fees and carried interests) are set off by the management fee, either in whole or in part. In this case, the amount of such proceeds set off against the management fee should be included in the regular information to LPs. The compensation percentage applied would, therefore, be reflected.

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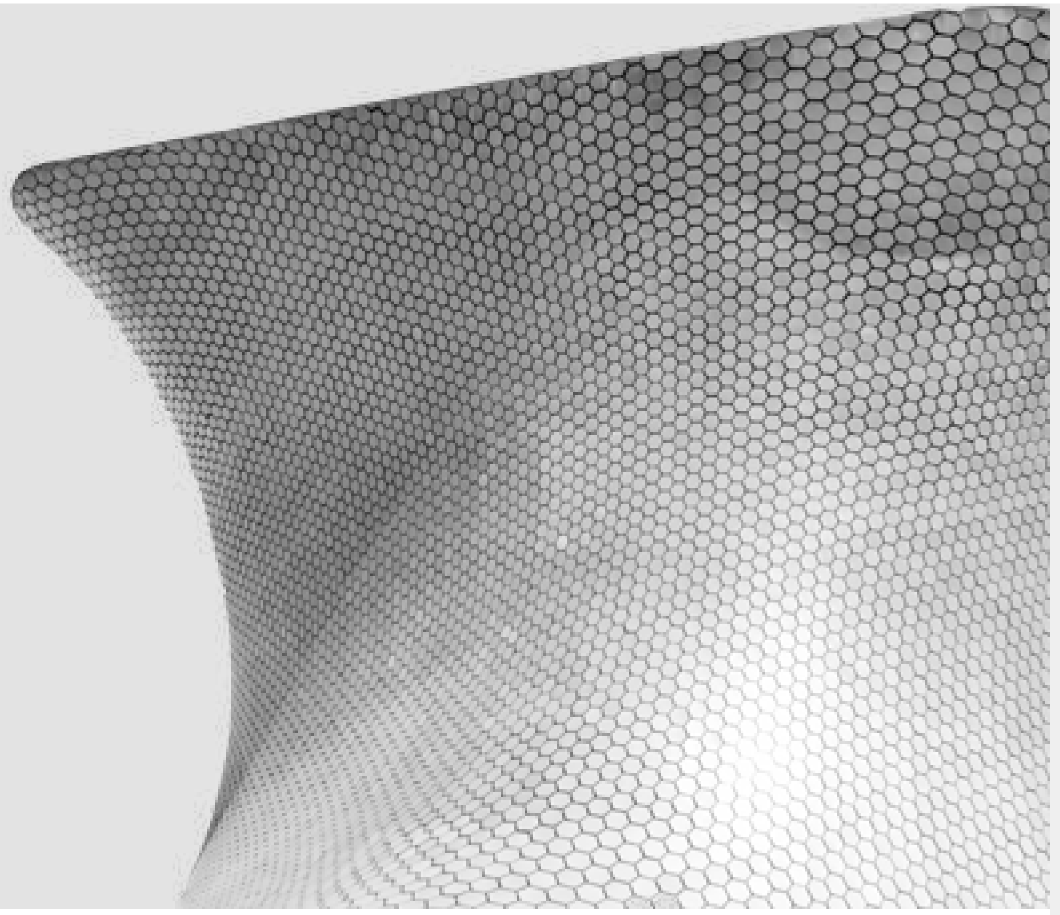


# 7. Setting up and operating expenses

## Relevant aspects

## Applicable best practices

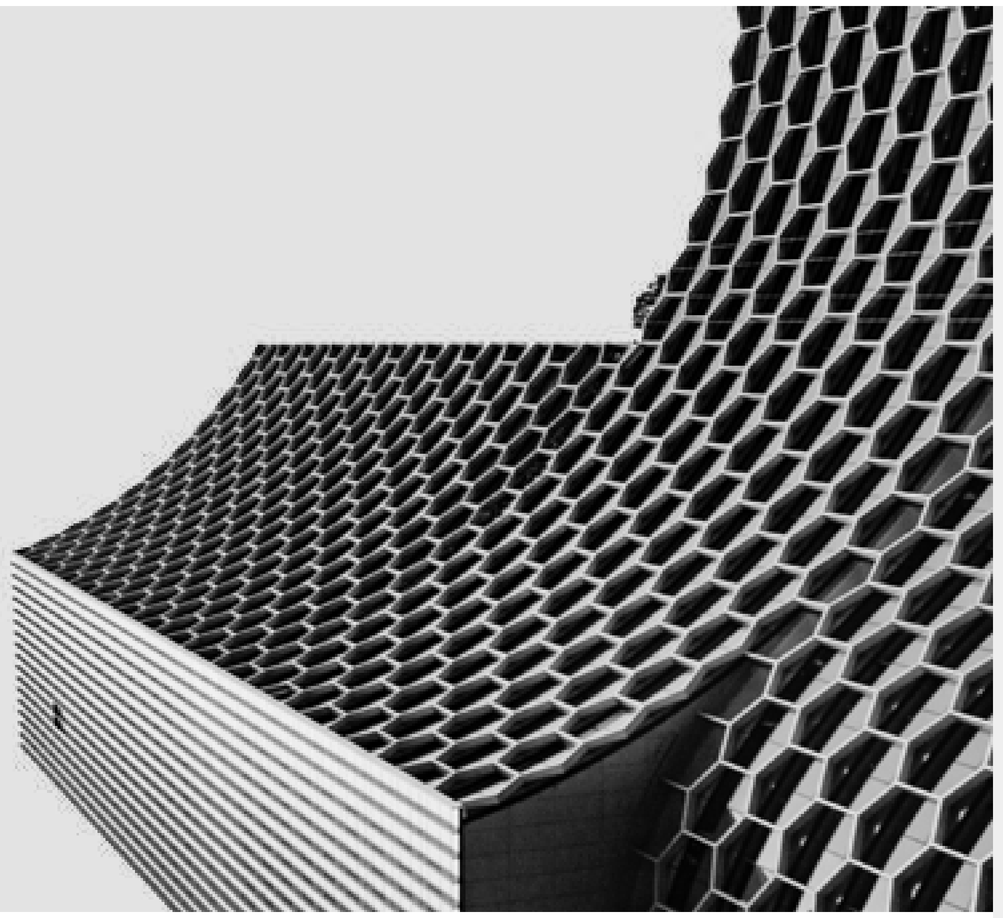
7.1. The LPA must clearly identify the type of organizational and marketing expenses that will be borne by the Fund and their limits with respect to its total investment commitments.

7.2. Usually, the setting up expenses assumed by the Fund include lawyers, accounting and administrative fees.

7.3. Likewise, the LPA must list (not necessarily exhaustively) the operating expenses of the Fund, such as auditing, legal advice, taxes, payment of service providers, notaries and records, etc., as well as the amount of these expenses to be borne by the Fund itself. Any excess over such limits should be borne by the GP.

7.4. The LPA may also establish a one-off structuring fee to cover the initial costs incurred by the GP with the setup of the Fund.

Block I | Alignment of interests



# 8. Co-investment

(with the GP)

## Relevant aspects

## Applicable best practices

8.1. If allowed, the LPA must provide for the possibility of the GP (as well as its partners, directors and employees) to make co-investments with the Fund or parallel investments in Portfolio Companies, establishing the specific conditions that must be met in such circumstances.

8.2. It is market practice for the LPA to determine that such co-investment take place only at the same time and subject to the same terms and conditions (including exit from such investment) as the Fund's investment in the Portfolio Company. In addition, such co-investment will be subject to prior scrutiny by the Fund's Supervisory Committee (or Advisory Board) and will require its non-objection to proceed.

8.3. The GP should not invest in targets that are more suitable for the Fund to invest. The Fund should invest in targets that are directly or indirectly owned by GP and its managers or family members, unless the Supervisory Committee has not objected.

8.4. The GP must always refrain from co- investing in deals that may potentially generate conflict of interests with the LPs.

Block I | Alignment of interests

# 9. Co-investment

(with LPs)

## Relevant aspects

## Applicable best practices

9.1. The conditions under which investors may co-invest with the Fund, as well as the criteria under which such opportunity of co-investing with the Fund can be made available by the GP to the LPs, should be regulated in the LPA.

9.2. The LPs should also be informed of any possible additional fees that the GP would be entitled to receive relating to co-investment executed opportunities.

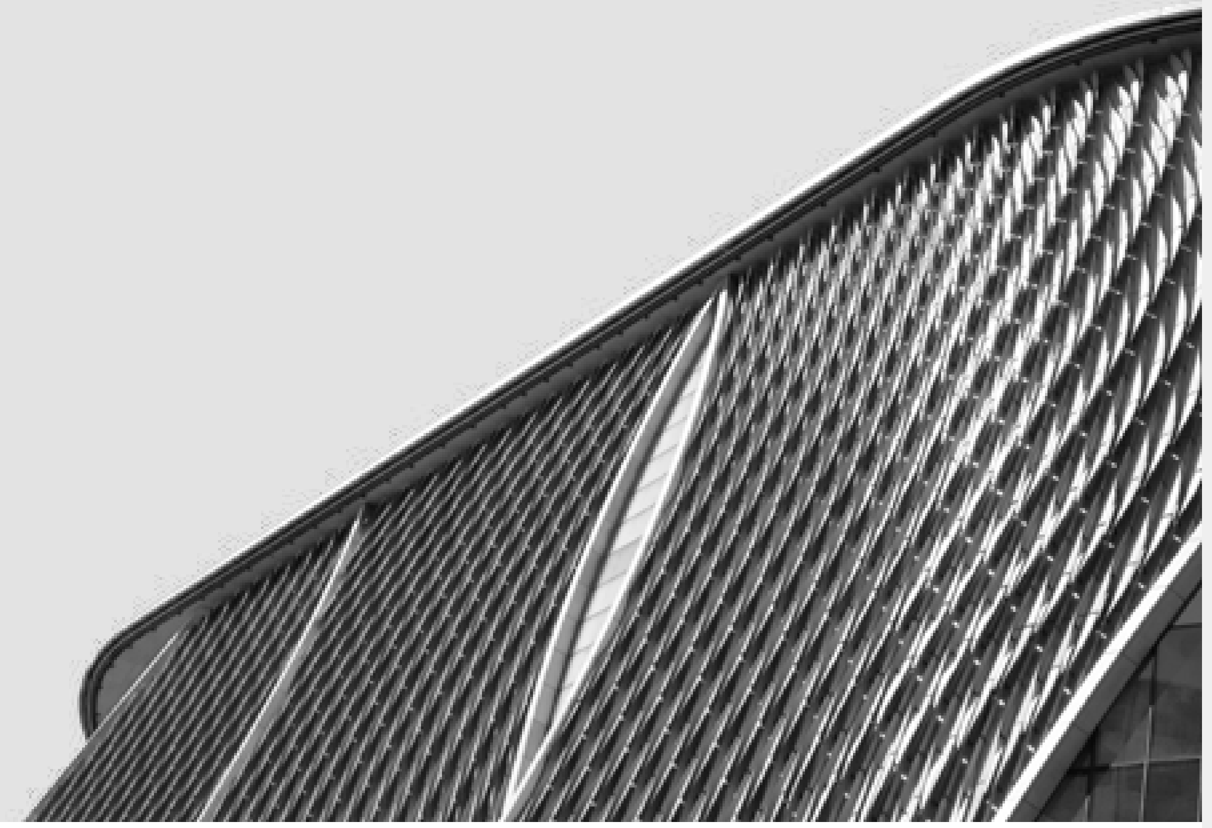
9.3. Co-investment opportunities shall only be presented to the Investors if aligned with the Fund´s best interests.

9.4. For strategic business development reasons and /or size of the Investor in the Fund, differential access to co-investment is possible, as long as this is provided by the LPA.

9.5. Usually, these co-investment situations should be previously submitted to the Supervisory Committee and subject to its non-objection.

Block I | Alignment of interests

# 10. Reporting



## Relevant aspects

## Applicable best practices

10.1. LPs shall be provided with annual reports including, among other aspects:

- details of investments made;
- the audited financial statements of the Fund;
- a breakdown of fees and expenses (at least covered by categories), particularly management and success fees, as well as income from underlying investments;
- an explanation of valuations, specifying the methodology used.

10.2. LPs shall also be provided with a quarterly report including, among other aspects:

- unaudited quarterly profit and loss statement and balance sheet;
- fund leveraging plan, including commitments and unpaid balances of the financing facilities used;
- information on material changes in investments;
- comments of the GP on changes during the quarter.

10.3. LPs shall be provided with a summary of investments and divestments made by the Fund, including a breakdown of them, with the corresponding safeguarding of data that may be subject to legal or contractual confidentiality requirements.

10.4. The GP will keep Investors informed of:

- any requirement or penalty imposed by the supervisory authorities on the GP or with respect to the Fund;
- material contingencies or responsibilities that arise or that are generated during the life of the Fund, and
- any material breach of any of the clauses of the LPA.

10.5. LPs shall keep the information aforementioned strictly confidential.

Block II

# Governance

Block II | Governance

# 11. Supervisory Committee

## Relevant aspects

The Supervisory Committee, also often called the Advisory Board, is presented as an advisory body for resolving issues of Fund governance, as well as possible conflicts of interest that may arise.

Generally, it is a body composed by the Fund's main Investors.

Subject to its proper running, the Supervisory Committee can be an especially relevant body for promoting and implementing good governance practices of the Fund and resolving situations where a conflict of interest may arise.

## Applicable best practices

11.1. The option for setting up a Supervisory Committee should be included in the LPA.

11.2. In such case, the LPA will list the composition and powers of the Committee, which generally comprise the valuation of assets that exceed the pre-defined maximum investment per Company, governance issues and terms and conditions of the Fund, and the resolution of potential conflicts of interest (e.g., those arising from related party transactions).

11.3. The Supervisory Committee resolutions cannot, in any way, replace the mandatory consent of the Investors for certain matters as provided for in the LPA.

11.4. The Supervisory Committee should meet at least once a year, but should be convened whenever necessary, by request of the GP or its members.

11.5. The GP should promptly inform the Supervisory Committee of any transactions during the investment period that may give rise to potential conflicts of interest, including any Fund's transactions with GP's related parties (e.g., partners, directors or employees).

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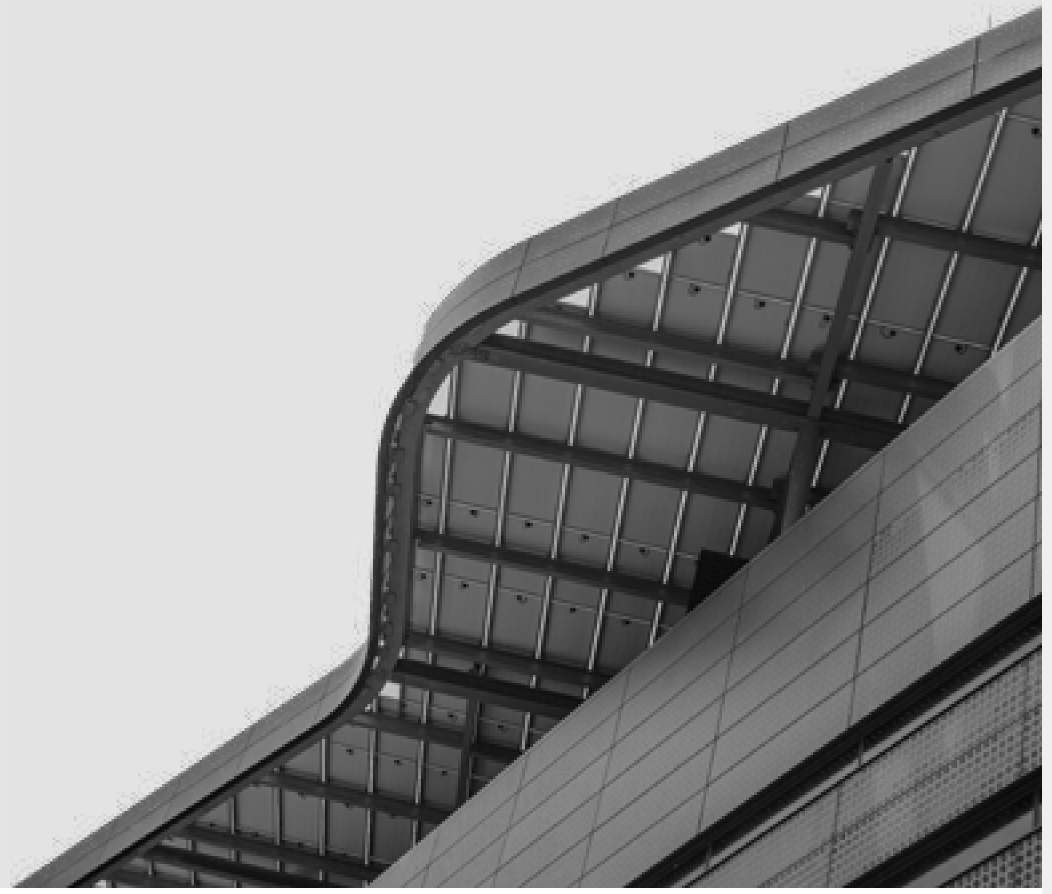


# 12. Removal of the GP

## Relevant aspects

## Applicable best practices

12.1. The removal of the GP, including the conditions on compensation of the GP in the event of replacement (with or without cause), is not laid down in the law, so these terms should be established in the LPA.

12.2. LPs may have the right to remove the GP without cause, upon a resolution with an appropriate majority (e.g. qualified) taken on a unitholders meeting.

12.3. However, removing the GP without cause should trigger a compensation to which the Manager may be entitled, as well as the possible payment of success fees accrued until the removal or after this, depending on the phase of the Fund's life cycle when the GP is removed (e.g., investment or divestment phase).

12.4. Likewise, Investors shall have the right to remove the GP with cause, which should be foreseen in the LPA (e.g., fraud, gross negligence, the committing of crimes of an economic nature related to the GP's activity, bankruptcy or material breach of their legal and contractual obligations). In such cases, the removal should be approved by a resolution taken by an appropriate majority (e.g. simple majority) of the unitholders meeting.

12.5. In case of a removal with cause, the GP should only be entitled to receive the Management fees accrued until the removal.

Block II | Governance

# 13. Key Executive Clauses

## Relevant aspects

## Applicable best practices

13.1. The LPA must identify the Key Persons or Key Executives.

13.2. The Key Person or the Key Executives are required to be part of the GP.

13.3. The Key Persons or Key Executives should inform the Investors of any situation that can substantially affect their dedication to the Fund.

13.4. The LPA must incorporate appropriate clauses relating to Key Persons or Key Executives, in particular:

a detailed description of the cases of departure of Key Executive(s), linked to lack of commitment or material breach and under what circumstances the Key Executive(s) departure may have harmful consequences for the operation of Fund, that is, the LPA should properly identify the Key Executive Events.

if the Key Executive(s) is/are not replaced within a given period of time following the occurrence of a Key Executive Event, the LPA should provide about the suspension of the investment period until such replacement takes place, unless the LPs, by means of the appropriate majority foreseen in the LPA, agree on the reopening of the investment period during the selection of a replacement Key Executive, or accept the departure of the Key Executive without the need for a replacement;

if no replacement is made for the departing Key Executive(s), or if their departure is not accepted without the need for replacement within a period established by the LPA, it must determine the measures determined that may include the replacement of the GP or the dissolution and winding up of the Fund, if so agreed by the LPs with the appropriate majority.

Block II | Governance

# 14. Investment Policy

## Relevant aspects

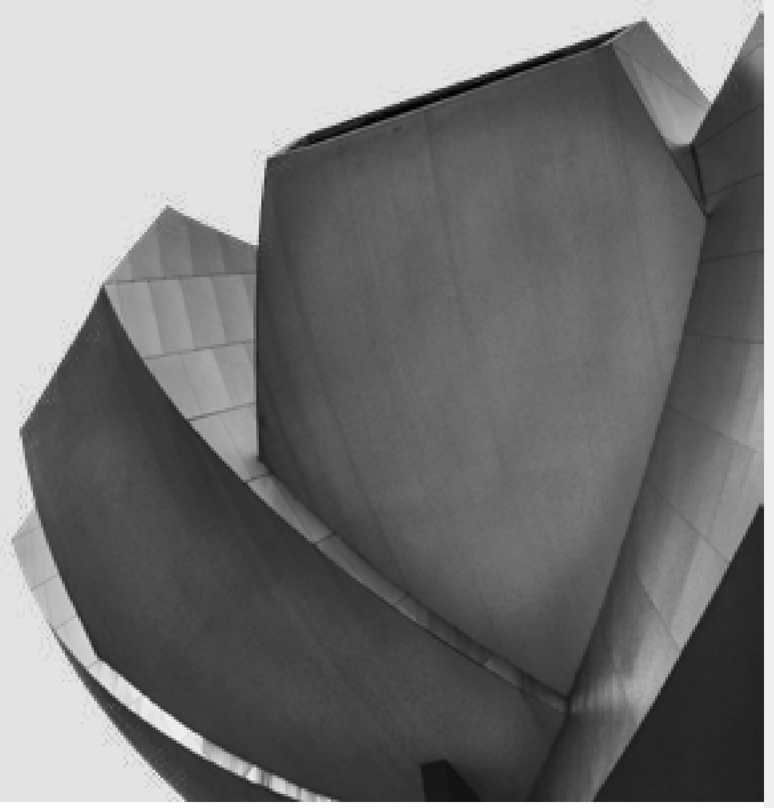
## Applicable best practices

14.1. The investment strategy must be clearly defined in the LPA, determining the relevant jurisdictions, the type of Portfolio Companies in which the Fund aims to invest, the maximum amount of each investment, concentration restrictions, indebtedness, as well as a list of excluded sectors in which the Fund will not invest.

14.2. The investment policy, comparable to the corporate object of companies, limits the range of action of the Funds and allows to differentiate them according to sectors in which they primarily invest and the types of investment they specifically intend to make, letting Investors to adequately choose the funds they want to participate in according to the principle of specialization.

Block II | Governance

# 15. Indebtedness



## Relevant aspects

## Applicable best practices

15.1. The following items must be regulated in the LPA:

The intention of the Fund to rely on indebtedness and its general aspects, including maturities and caps. If using indebtedness is not expected, it should be indicated.

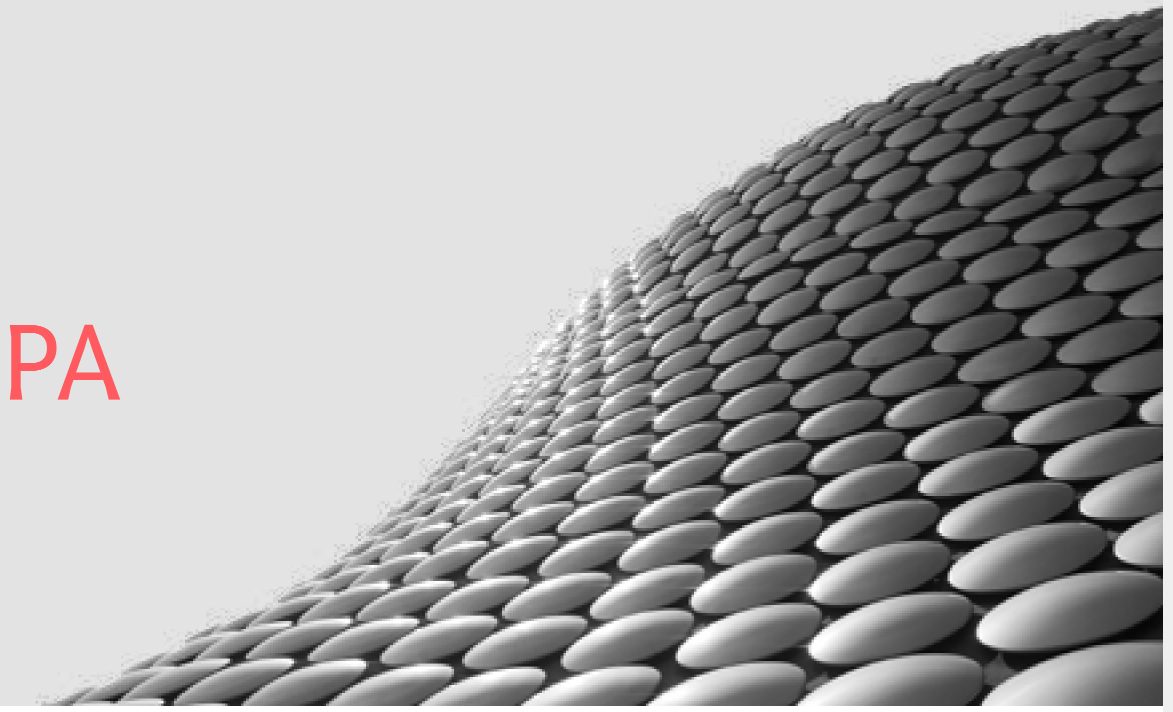
The reasons for using debt and restricting its use (e.g., to finance investments of a temporary nature, to make additional investments, capital commitments available to cover this liability).

Information on the financing used and main terms thereof shall be included in the regular reports to LPs.

15.2. If it is deemed relevant, the LPA may include the explanation of the possible effect of the financing on the internal rate of return (IRR) of the Fund.

Block II | Governance

# 16. Modification of the LPA



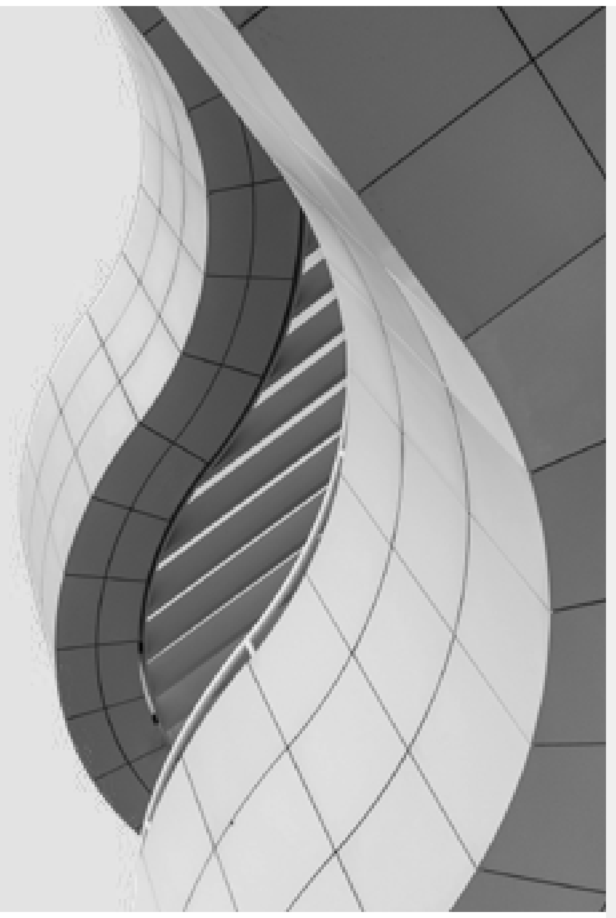
## Relevant aspects

## Applicable best practices

In general, changes to the LPA are subject to the non-objection of the Supervisory Committee and to the approval of the LPs. Qualified majorities may be established for significant amendments.

Block II | Governance

# 17. Investment Committee



## Relevant aspects

## Applicable best practices

The LPA may provide for the possibility of creating an Investment Committee, in which case it must regulate its functioning.

Block III

# Deal Structuring and Investment Strategy

Block III | Deal Structuring and Investment Strategy

# 18. Deal Structuring and Investment Strategy

## Relevant aspects

The Manager should promote an alignment of interests and incentives in deal structuring to fulfill the investment strategy.

## Applicable best practices

18.1. The GP should assess the potentially available investment instruments and determine which is appropriate for each deal – e.g., equity instruments, equity-like debt, a combination of debt and equity financing. In pure venture capital deals , loan-to-equity tools (e.g., convertibles or warrants) may be considered to bridge to higher financing rounds or investments in industries with higher capital demands.

18.2. The GP should select appropriate financing structures, balancing risk and return. Structuring of venture capital deals may require the alignment of interests between several Investors led by one or more lead investors.

18.3. The GP should anticipate the desired approach for exit strategies (e.g., trade sale, sale by public offering, sale to another equity investor, sale to a financial institution, or management buyout (MBO).

18.4. The GP should have a preliminary assessment of the full value chain of each potential investment, identifying risks and opportunities including assessment of ESG risks and opportunities.

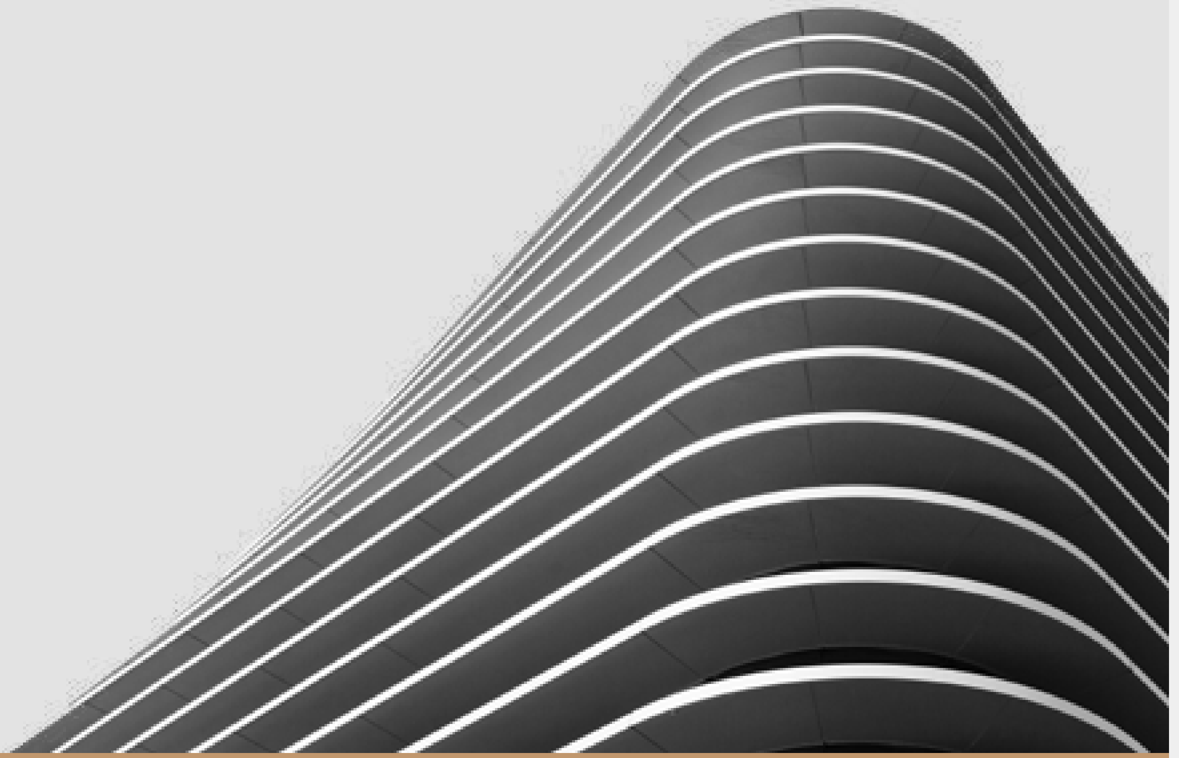
18.5. The GP should design high-powered incentives for the management team, key employees and/or other key persons of the Target aligned with the goals of the deal, granting the beneficiaries part of the returns resulting from an exit.

18.6. The GP should assess benefits and downsides for seller's roll over as an alignment of incentives going forward and optimizing the likelihood of a strong outcome.

Block IV

# Transparency

Block IV | Transparency



# 19. Fees and Expenses

## Relevant aspects

The GP shall keep Investors regularly informed on the level of fees and expenses charged to the Fund.

## Applicable best practices

19.1. The regular reports sent to Investors must include a breakdown of fees and expenses (at least on a category basis) charged to the Fund.

19.2. Investors must be able to assess if the expenses incurred by the Fund comply with the provisions of the LPA.

Block IV | Transparency

# 20. Side Letters

## Relevant aspects

The investment conditions agreed with Investors can be the result of negotiations between the GP and the potential Investor.

Bearing in mind the diverse nature of the Investors, it is usual that, as a condition precedent for investing in the Fund, some investors request specific conditions, preferential rights or economic benefits (e.g., being a member of the Supervisory Committee, having preferential access to co-investment opportunities, payment of a reduced management fee, etc.).

These agreements must comply with the Portuguese legal framework, transposing the AIFMD, which requires in general that Investors are treated equally.

## Applicable best practices

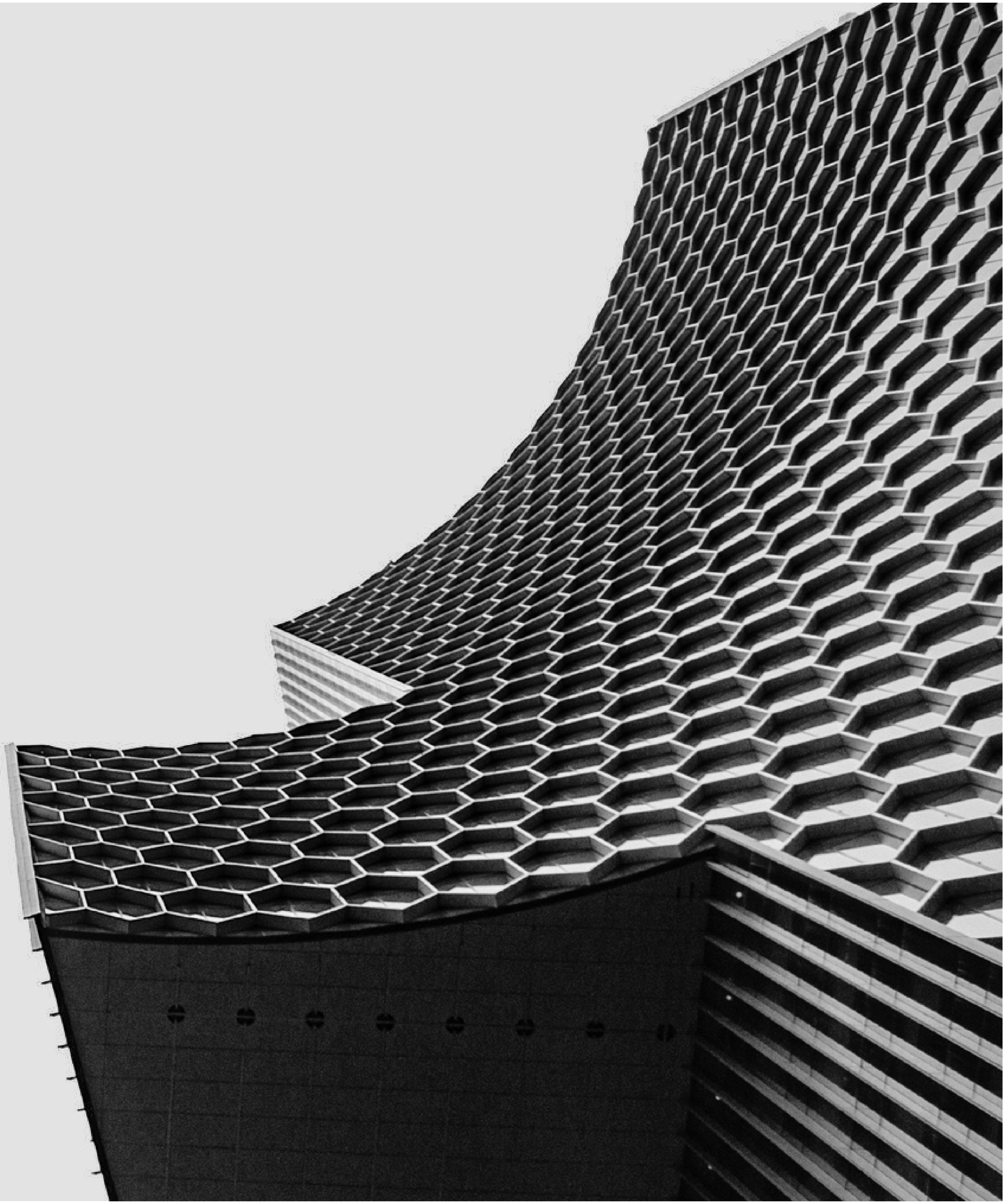
20.1. The GP shall ensure that all Investors are treated equally and fairly.

20.2. The LPA can consider the possibility of establishing particular agreements with certain Investors (side letters or side agreements), which must be accessible to LPs in the terms provided in the LPA.

20.3. The existence of a side letter should have objective justification (e.g., because of the amount committed by the Investor, experience and added value that they can contribute to the Fund, etc.).

20.4. In some cases, depending on the circumstances of the Investor, "most favored nation" clauses may be included, under which the Investor would be granted a right to be entitled to any conditions that could be agreed afterwards with other Investors which are more favorable than the ones agreed with such Investor.

20.5. These favorable conditions must be reflected in the LPA through the possibility of establishing different unit classes.



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