

Consent rights in seed investment transactions

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As the majority of today's seed transactions are structured as a top-line revenue share, paid directly by the fund, rather than a direct equity ownership stake in the management company, a seeder will often have little direct control over the governance and actions of a seeded manager and will correspondingly have less transparency into the manager's operations.

Despite this, savvy seeders recognise the need to prevent a manager from using its flexibility to act contrary to the seeders' best interest, whether in respect of the revenue share or the seed investment itself.

A core category of these protections are consent rights, which allow the seeder, at a minimum, a "seat at the table" when material decisions are made that could affect the seeder's interests.

Seeders often request a variety of consent rights when making a seed investment – typical seed deals will include one or two dozen consent items covering a wide range of potentially adverse actions.

These rights are oriented to provide protections for the seed investment and to recreate the protections against the "tyranny of the majority" that a typical minority investor would seek.

At their core, these rights are intended to limit the manager's ability to unilaterally take any action that could adversely affect the seeder's revenue share, or that would fundamentally alter the terms of the seeder's investment in the fund.

This latter point is particularly important during any lock-up period, during which time the seeder is unable to withdraw its seed investment except in narrow circumstances.

Most common provisions

The most common consent rights that typically appear in seed transactions include: amendments to fund documents or investment guidelines; changing the fund's auditor or tax election(s); issuance of equity in the manager or issuing material debt by the manager; launching new products; releasing employees from non-competes; sale of the manager; and liquidation of the entire business.

There are variously intended to maintain the status quo of the terms of the seed investment, protect the long-term value of the seed, ensure the manager is focused on its core product offering, and that the key person continues to have skin in the game.

The foregoing consent rights are most often perpetual throughout the term of the seed relationship.

However, in some deals, certain rights (especially fund-related rights) may expire after a certain period of time, often coinciding with the termination of any lock-up period, or if the seeder's investment falls below a set threshold.

The rationale for such expiration is that if the seeder can withdraw (or has withdrawn) its investment from the fund, it can protect itself by exercising its right to withdraw, rather than protecting itself via contract.

The counter-argument to the first point is that while a seeder may be able to withdraw, it may not wish to reallocate what may be a sizable investment, especially since it has most likely expended considerable resources diligencing the manager.

Moreover, changes in strategy and structure can negatively impact the value of a seeder's capacity rights.

While seeders' interests are significantly protected by the structure of their interest, well-formulated consent rights that correspond to the needs of the particular situation are a key means of de-risking a seed investment and allowing the parties to transact more freely.

Properly negotiated, protection can be provided to the seeder while giving managers maximal operating autonomy



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