From: Ada Clapp <[redacted]>
To: jeffrey E. <[redacted]>
Subject: RE: LDB 2011 LLC Restructuring
Date: Fri, 13 Jun 2014 19:09:03 +0000

Well you certainly know that I prefer to be cautious! Do you still want Okun or Fenn to review?

From: jeffrey E. [mailto:[redacted]]
Sent: Friday, June 13, 2014 3:05 PM
To: Ada Clapp
Subject: Re: LDB 2011 LLC Restructuring

i want to be careful, these numbers are larger than most so precedent is not perfect. . it is the easiest way to attack

On Fri, Jun 13, 2014 at 2:30 PM, Ada Clapp <[redacted]> wrote:

> The promissory note between the APO1 Agreement and Ben's 2011 Trust provides for annual payment of interest. I think that is a better fact than accruing interest—however, I have prepared and seen many intra-family notes that provide for the accrual of interest to accommodate a lack of liquidity on the borrower's part. As long as you have enough other factors establishing that it is real debt, I think you are OK.
>
> **From:** jeffrey E. [mailto:[redacted]]
> **Sent:** Friday, June 13, 2014 2:23 PM
> **To:** Ada Clapp
> **Subject:** Re: LDB 2011 LLC Restructuring
>
> im not so sure regarind 9 years of accrued interstn/ thoughts?
>
> On Fri, Jun 13, 2014 at 2:19 PM, Ada Clapp <[redacted]> wrote:
>
> > Hi jeffrey,
> >
> > Let me give you some background and after hearing/reading it, let me know if you still want Brad Okin or Pat Fenn to review.
> >
> > Alan and I had a lengthy discussion on the structure of the sale and the documents required. I was unhappy with the documents originally provided as I did not think they were adequate. I therefore redrafted the Purchase and Sale Agreement and Promissory Note and also prepared a Security Agreement. My intention was to create a bona-fide debtor-creditor relationship, as discussed below.
> >
> > After the below email exchange, Alan polled members of the Trusts & Estates Bar to find out if most practitioners were structuring their sales by taking a security interest. He learned that, in fact, most <u>were</u> taking a security interest and found my below arguments persuasive. Alan decided to change Paul Weiss's practice in this regard and to use a version of the sale documents I proposed (they opted to use a pledge agreement in lieu of a security agreement as discussed below).

As you can see, to be sure that the sale documents were commercially reasonable, Alan asked one of Paul Weiss's associates in the Corporate Finance group, Aaron Wax, to review and comment on them. Aaron had worked with us previously on the Black Family Partners credit facility to Phaidon. Aaron tweaked the sale documents a bit more and the final versions are what I sent to you earlier today.

See dialog below:

From: Halperin, Alan S [mailto:[redacted]]
Sent: Sunday, May 04, 2014 2:10 PM
To: Ada Clapp
Cc: Hurtado, Christopher L; Eileen Alexanderson
Subject: Re: LDB 2011 LLC Agreement

Thanks, Ada. Let me reflect as to what is best, and then revert. Chris, let's discuss tomorrow. Alan

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Alan S. Halperin | Partner
Paul, Weiss, Rifkind, Wharton & Garrison LLP
[redacted]

From: Ada Clapp [mailto:[redacted]]
Sent: Sunday, May 04, 2014 02:03 PM
To: Halperin, Alan S
Cc: Hurtado, Christopher L; Eileen Alexanderson <[redacted]>
Subject: FW: LDB 2011 LLC Agreement

Hi Alan,

I see the analysis as follows:

Transfers between family members are presumed to be gifts unless the transferor/seller can establish that it received full and adequate consideration for the transfer. So, in the case of an installment sale, the gift tax issue turns on establishing that the face value of the Note which the purchaser gives the seller is equal to the fair market value of the property being purchased. If it is, then you can establish that the note given to the seller is debt rather than a retained equity interest (your 2036 concern).

We all operate under the assumption that a Note charging interest at the AFR has a fair market value equal to its face amount and will be respected as debt. However, as you know, the service is starting to challenge this assumption. I agree that a loan at the AFR is not a "commercial loan" but there are PLRs which support that no gift results when the AFR is used. Being a "commercial loan' is not really the benchmark, as you note. Rather the practice is to set up intra-family transactions, to the extent possible, using "commercially reasonable terms" to avoid the gift presumption (and, some say, to bolster the argument that the Note has a fair market value equal to its face amount). This is done to create a bona-fide loan and a debtor-creditor relationship which affirmatively establishes the settlor's real intention to be repaid.

As you know, there are a number of factors practitioners have used to do this, including (i) charging interest at or above the AFR (ii) establishing a fixed repayment schedule (iii) showing that payments have been made pursuant to such schedule, (iv) securing or collateralizing the debt and (v) establishing that the purchaser has and maintains adequate solvency to repay the note. The more factors you have, the stronger your argument is that the note is debt. I agree that 7872 does not *require* the seller to take security. Instead, the purpose of doing so is to establish the seller's intent to enforce the debt obligation and get repaid.

I know that some practitioners have stopped having the seller take collateral, finding it too burdensome to perfect the security interest. Instead, they have opted to use other means of establishing a bona fide debtor/creditor relationship. As you suggest, in lieu of security they include restrictive covenants in the loan documents preventing the purchasing trust from making distributions to beneficiaries in excess of a specified amount until the note is repaid, and/or incurring additional debt beyond a certain debt/equity ratio. However, I did not see any restrictive covenants in the Purchase and Sale Agreement and Promissory Note you provided. This is why I proposed revising the documents to provide for security. I also thought it was more consistent with what we did in the substitution transaction (and that it would be best to be consistent, recognizing of course that each transaction is different).

The point in my below email is that if you (I mentioned your finance lawyer because you previously determined that he/she needed to review the documents for this purpose) feel that the provisions included in the loan documents you propose are sufficient to establish a bona fide debtor-creditor relationship without the need to take security, I am fine with that. I would image, however, that you will want to include the restrictive covenant you mentioned.

I am happy to discuss but leave this to your discretion.

Ada Clapp
Elysium Management LLC
[redacted]

From: Halperin, Alan S [mailto:[redacted]]
Sent: Wednesday, April 30, 2014 2:11 PM
To: Ada Clapp; Hurtado, Christopher L
Cc: Eileen Alexanderson
Subject: RE: LDB 2011 LLC Agreement

Hi Ada.

If we are dealing with installment sales between a grantor and a grantor trust, as a gating matter, I think the issue turns on an estate and gift tax analysis, not necessarily what a financing lawyer recommends. With transactions

between the grantor and his grantor trust, it is not clear to me that, from an estate tax perspective, the note should be secured. There are two schools of thought. On the one hand, I am sensitive of the desire to make the transaction appear commercially sound. However, we know that a loan at the AFR is below market, and no bank extends loans at that rate. Further, 7872, dealing with the gift and income tax consequences of below market loans, does not require security. If commercial reasonableness is the test, we likely fail with any loan at the AFR. Yet, we know that a loan at the AFR is not a gift. So the question then becomes whether there is any downside risk if there is security. Here, I am sensitive to the argument that, if the grantor has retained the security and such security exists at the time of death, the IRS may argue that the grantor has retained an interest in the trust under 2036.

In the early years of my practice, I too was concerned with the commercial reasonableness of the transaction, and therefore would provide for security when a grantor sold to his trust. Over the years, however, I became more concerned with the 2036 risk, particularly because AFR loans are not commercial. In light of the foregoing, if the grantor is the selling party, I tend to include a covenant in the sales document by which the purchasing trust agrees not to take any action, including a distribution, which would jeopardize the ability of the trust to repay the loan. But I tend not to provide for security.

Here, the transaction is not between the grantor and a grantor trust. So I am not concerned with 2036. We could provide for security, but I suspect that we still fall short of commercial reasonableness due to the rate. In short, I do not think this transaction necessarily should set a precedent of what we recommend for a transaction involving the grantor.

I am happy to discuss. Alan

Alan S. Halperin | Partner
Paul, Weiss, Rifkind, Wharton & Garrison LLP
[redacted]

From: Ada Clapp [mailto:[redacted]]
Sent: Wednesday, April 30, 2014 1:41 PM
To: Hurtado, Christopher L
Cc: Halperin, Alan S; Eileen Alexanderson
Subject: RE: LDB 2011 LLC Agreement

Since we will likely use these forms of document going forward for installment sales, we should take whichever approach Paul Weiss advises. My concern is that the transaction is done on commercially reasonable, arms-length terms that would be agreed upon between unrelated parties. If your finance lawyer feels that unrelated third parties would do the sale without security or a pledge agreement, he or she certainly knows better than I do! Thanks again.

Ada Clapp
Elysium Management LLC
[redacted]

From: Hurtado, Christopher L [mailto:[redacted]]
Sent: Wednesday, April 30, 2014 12:47 PM
To: Ada Clapp
Cc: Halperin, Alan S
Subject: FW: LDB 2011 LLC Agreement

Hi Ada,

I am writing to follow up on the status of the LLC restructuring project. As you will recall, the last open item on our end was to have a finance lawyer review the Promissory Notes and Security Agreements. (We appreciate that we also still await Jeffrey's approval of the Use Agreements, but that in the meantime, we can move forward with the other items).

The finance lawyer indicates that the Notes are in order. In terms of the form Security Agreement, you will recall that you drafted it in an effort to make the transaction more "arms-length." However, we are advised that under the UCC, there are specific requirements to perfect a security interest in uncertificated securities (such as LLC membership interests). Among other things, the pledgor must grant control of the security interest to the secured party and make certain related representations. This typically is accomplished through a Pledge Agreement rather than a Security Agreement.

Accordingly, we believe there are two possible approaches:

1. We may proceed with Pledge Agreements in place of the Security Agreements. If we adopt this approach, we are happy to draft the new Pledge Agreements.
2. We may proceed without security. This approach may be consistent with prior intra-family transactions.

On balance, we are comfortable proceeding without security.

Please let us know how you would like to proceed or if you would like to discuss further.

Best,
Chris

From: Halperin, Alan S [mailto:[redacted]]
Sent: Tuesday, March 25, 2014 11:38 AM
To: Ada Clapp
Cc: Hurtado, Christopher L
Subject: LDB 2011 LLC Agreement

Ada,

I am attaching a clean and blackline copy of the Amended and Restated LLC Agreement for the LDB 2011 LLC. The revised Agreement reflects the changes you communicated as well as the simplified allocation of profit and loss in accordance with Rich's request.

In light of your desire to have the Purchase and Sale Agreement and Promissory Note more akin to an arms-length transaction with a third party, we are having a Finance lawyer review the proposed forms (along with your proposed form Security Agreement). On a related note, in the Purchase and Sale Agreement, you raised the issue of what interest rate to use. I remain comfortable using AFR, but am happy to discuss.

As to the balance of the documents, we have made the changes as you suggested. Would you like us to send revised copies to you?

Alan

Alan S. Halperin | Partner
Paul, Weiss, Rifkind, Wharton & Garrison LLP
[redacted]

From: jeffrey E. [mailto:[redacted]]
Sent: Friday, June 13, 2014 1:43 PM
To: Ada Clapp
Subject: Re: LDB 2011 LLC Restructuring

same issue, i would lke brad okun or fenn to opine on these notes

On Fri, Jun 13, 2014 at 1:03 PM, Ada Clapp <[redacted]> wrote:

> Hi Jeffrey,
>
> Hope that you are having a good day.
>
> Attached are the sale documents in connection with the LDB restructuring. At our last meeting, you indicated that you wanted to review them. As a reminder, each of the children's 2011 Trusts will sell its one-fourth interest in the restructured LDB 2011 LLC to the APO1 Trustees in exchange for a note (purchase price to be determined by appraisal). The attached are for a sale between Ben's 2011 Trust and the APO1 Agreement. They will be "cloned" for the other children's trusts. We are set up for a June sale and I await your comments on these documents before circulating for signature.
>
> Best regards,

Ada Clapp
Elysium Management LLC
[redacted]

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