

# Elysium Management LLC

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To: Leon D. Black  
From: Ada Clapp  
Cc: Bradley J. Wechsler and Alan Halperin  
Date: February 22, 2016  
Re: AP Narrows LP—Overview

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## **I. Creation of the Partnership.**

AP Narrows LP (the “Partnership”) will be a family investment vehicle through which art and other investments will be acquired, held and sold. One of its principal purposes will be to acquire and manage a diversified portfolio of fine art for investment purposes.

A. Purposes for Creating the Partnership. One or more family trusts and you will contribute art to the Partnership to accomplish the following objectives:

- To reduce market risk by combining their separate art holdings into a single more diversified collection;
- To create a common ownership of assets to provide for efficient management and reduction of expenses resulting from cost efficiencies and potential tax deductions;
- To have their art holdings managed and invested by an experienced, preeminent art investor (a factor of great importance to the Trustees who seek professional management of these assets);
- To avoid repetitive asset transfers and fractionalization of ownership among multiple generations; and
- To provide transfer restrictions appropriate for joint ownership and management of a large art collection for the benefit of family members.

Attached is a Term Sheet outlining the proposed structure, funding, ownership and governance of the Partnership.

B. Other Considerations. To the extent that existing appraisals of art holdings are outdated, appraisals will be required each time capital is contributed to the Partnership, and again if art is distributed or withdrawn in-kind. Additional

capital will need to be contributed (or art may have to be sold) to cover costs and expenses.

Contributing assets to a partnership introduces an extra layer of complexity as compared with individual ownership. For example, if a partner wishes to use (rent-free) or withdraw (to make a charitable donation) a work of art from the Partnership's art holdings, consent of the Class B GP is required.

## **II. Formation Mechanics.**

Once you (as Class B GP and LP), Narrows Holdings LLC (as Class A GP and LP) and the APO-01 Declaration (the "APO-01 Trust") (as LP) have signed the contribution agreements, the art will be contributed to the Partnership and \$2 million (for initial operating expenses) will be transferred from the APO-01 Trust to the Partnership.<sup>1</sup> The APO-01 Trust will also subscribe to contribute up to \$200 million of additional assets, over time, when called by the Class A GP.

Next, the APO-01 Trust will decant approximately \$5.3 million to the APO-B Trust (Brad as Trustee) which will use the funds to purchase your 2% Class B GP interest from you.

## **III. Management and Administration.**

While you do not currently intend to make transfers of your Partnership interests to family members or trusts, you may decide to do so in the future. Accordingly, the Partnership should be managed and activities conducted in pursuit of the business purposes for which it was created. Not only does this make good business sense, but doing so may prevent a claim by (i) the IRS that those transferred interests should be included in your estate at your death, and/or (ii) the New York State taxing authorities, in connection with a sales tax matter, that the Partnership did not have a valid business purpose.

A. Management. Management of the Partnership is bi-furcated between two classes of general partners, with powers that might trigger estate tax inclusion held by the Class B GP (the APO-B Trust, through Brad) and all other powers, including investment decisions, held by the Class A GP (Narrows Holdings LLC, through you). These powers are more specifically outlined in the attached Term Sheet.

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<sup>1</sup> While the Trustees actively negotiated the terms of the Partnership formation and funding documents, they may wish to retain independent counsel to advise them. I note that the IRS recently raised the failure of all parties to have independent counsel as one factor supporting inclusion of previously transferred partnership interests in the estate of a deceased partner (*i.e.*, to refute the bona fide sale exception under Section 2036 of the Internal Revenue Code).

Each GP should carry out its designated responsibilities and should make only those decisions it is permitted to make under the partnership agreement. For example, while only the Class B GP may consent to allow a partner rent-free use of art investment assets, the Class A GP has exclusive discretion to permit fair market rental of such art and/or to lend it for museum exhibition. Activities undertaken in connection with the Partnership's art holdings should be undertaken at the Partnership, not individual, level. Contracts and agreements signed on behalf of the Partnership should be signed by appropriate officers acting in their Partnership (not individual) capacities.

Consistent with the purposes of the Partnership, it is assumed that the Class A GP will make periodic acquisitions of art, direct an occasional sale, engage in discussions regarding museum exhibition loans of the Partnership's holdings (to enhance value via public display), and direct that certain art assets be maintained in storage facilities. To further those purposes, the Class A GP will work with outside professionals and advisors, including appraisers to value the Partnership's art holdings at least annually. These professionals may be retained individually by the Partnership or pursuant to a joint agreement with others (discussed below).

- B. Partnership Formalities. The GPs should observe partnership formalities. The Partnership should have a separate business address and phone number (*e.g.*, Elysium) and should not use the personal address or phone number of any of its partners. The Partnership should hold periodic meetings (with written agendas and minutes) to review and discuss Partnership holdings and formulate future plans to further the Partnership's objectives. Records should be kept of key decisions. For convenience of the partners, Partnership meetings could be held immediately following quarterly Trustees meetings.
- C. Financial Reporting. The GPs should review and discuss the Partnership's tax returns with the accountant who prepares them. The Partnership should prepare annual reports for its partners that (i) discuss the Partnership's activities and future plans and (ii) include a year-end financial statement showing the Partnership's investments, their estimated market value, asset purchases and sales, gains and losses on investments and any change in investment strategy. In addition, the Partnership should prepare quarterly reports showing purchases or sales during the quarter, each partner's percentage interest in the Partnership and anticipated capital needs for the upcoming quarter.
- D. Books and Records. The Partnership should keep books and records and should maintain a separate capital account for each partner. This account should be adjusted to reflect additional capital contributions (required only for the APO-01 Trust pursuant to its Contribution and Subscription Agreement). Profits and losses for any period should be allocated to each partner in accordance with such partner's ownership percentage. Initial books are being prepared by Joe to reflect

initial capital contributions and Rich will be handling the tax aspects of the Partnership.

- E. Partnership Account/Expense Allocation. The Partnership should maintain a separate bank account and care should be taken to ensure that a partner's personal assets are not comingled with Partnership assets.

Partnership expenses should be paid by the Partnership from the Partnership's account and the Partnership should not pay personal expenses of any partner. Where the Partnership engages a service provider (such as an art consultant, art attorney or insurance provider), fees payable to such service provider should be billed to the Partnership. If the service provider provides services to the Partnership and to one or more partners pursuant to the same agreement or arrangement, the service provider's fees will be allocated among the Partnership and the partners receiving services in a manner to be agreed upon by the Partnership and such partners and each party should pay its allocated portion of such fees directly to the service provider.

- F. Day-to-Day Operations. To the extent that the Partnership does not hire employees to assist the GPs with the day-to-day operations of the Partnership, Elysium Management LLC ("Elysium") would assist in this regard. To the extent that Elysium does so, it should be treated as a service provider. Fees can be allocated pursuant to an Administrative Services Agreement or via another agreed upon arrangement.

#### **IV. Post-Formation Steps.**

- A. An appraisal should be obtained to value the initial capital contributions to the Partnership. The Partnership's books should be updated to reflect each partner's initial capital contribution.
- B. The Class A GP should appoint Officers to manage and oversee the day-to-day operations of the Partnership and should delegate appropriate authority to them.
- C. The GPs should agree upon a method of (i) calculating Elysium's fees for services, and (ii) allocating fees of art advisors who provide services to both a partner and the Partnership (*e.g.*, George Goldner, Diana Howard, *etc.*). Consider having Elysium retain such advisors directly and allocate their fees accordingly.
- D. Each partner should sign the Insurance Agreement and his/its fine arts insurance policy should be amended to include the Partnership as a named insured with respect to works of art contributed by such partner.
- E. An Art Use Agreement should be entered into if any partner is permitted to use Partnership art.

- F. Partnership accounts should be opened with Christie's, Sotheby's and Dietl.
- G. The Partnership should subscribe to publications and websites relevant to art investing.
- H. The Partnership should maintain its own collection management system.