

[Podcast]: VCOC Management Rights

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In this episode of the Proskauer Benefits Brief, partner [Ira Bogner](#) and senior counsel [Adam Scoll](#) discuss VCOC "Management Rights." For VCOC compliance purposes, "management rights" are contractual rights directly between an investing entity and an operating company by which the investing entity can substantially participate in, or substantially influence the conduct of, the management of the operating company. Unfortunately, there is not a ton of guidance out there explaining what constitutes sufficient VCOC "management rights," so make sure to tune in to this podcast to hear our views.

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Adam Scoll: Hello, and welcome to the Proskauer Benefits Brief: Legal Insights on Employee Benefits and Executive Compensation. I'm Adam Scoll, Senior Counsel in the firm's Boston office, and I'm here with Ira Bogner, partner in our New York office, and today we will be discussing VCOC "Management Rights."

By way of background, generally speaking, for an entity to qualify as a "venture capital operating company", or "VCOC", at least 50% of the entity's assets (valued at cost), must be invested in operating companies with respect to which the entity has management rights, and the entity must actually exercise such management rights with respect to one or more such operating companies in the ordinary course of its business.

Ira Bogner: Right. "Management rights" are contractual rights directly between an investing entity and an operating company, by which the investing entity can substantially participate in, or substantially influence the conduct of, the management of the operating company. Unfortunately, there is not a ton of guidance out there explaining what constitutes sufficient management rights for these purposes.

Adam Scoll: In the preamble to the plan assets regulation, which is the regulation containing the applicable VCOC rules, the Department of Labor generally declined to limit or define the types of rights that will constitute management rights. Further, the Department of Labor noted that whether a set of rights obtained by a VCOC constitutes sufficient management rights is an inherently factual question to be determined by taking into account the particular facts and circumstances of each case. But the DOL has noted that a VCOC does not need to have the power to direct a portfolio company's management to comply with the VCOC's input.

Ira Bogner: Based on a discussion in the preamble to the proposed version of the plan assets regulation, and on the practice that has developed since the plan assets regulation was issued, the right to a seat on a company's board of directors should constitute management rights, but the right to the board seat must be a direct contractual right with the company. Thus, even where it is understood that the VCOC will have a board seat, for example where the VCOC holds the majority of a class of stock entitled to elect a director, care should be taken to document the right to the board seat.

Adam Scoll: That being said, obtaining a board seat is not the only way to acquire sufficient management rights. Helpfully, the Department of Labor concluded its advisory opinion 2002-01A that where a VCOC was given the right to receive certain financial statements from the operating company and its subsidiaries, the right to inspect and access copies of documents, reports, financial data and other information of the operating company and its subsidiaries, the right to visit and inspect any of the properties of the operating company and its subsidiaries, and the right to consult with and advise the management of the operating company and its subsidiaries on reasonable notice and at reasonable times on all matters relating to the operation of the operating company and its subsidiaries, the investor had obtained sufficient VCOC management rights.

Ira Bogner: However, the VCOC that requested that advisory opinion letter represented that such rights were greater than the rights normally obtained by institutional investors in portfolio companies, and the Department of Labor acknowledged that this representation was a factor in making its determination. Because there is less certainty about what rights, other than a board seat, qualifies management rights, we typically advise clients to obtain a strong a set of rights as they can, rather than asking us what is the least they can live with.

Adam Scoll: Again, a VCOC's rights need to be direct contractual rights in order to satisfy the requirements of the VCOC rules. A common misconception is that a separate VCOC management rights letter is required. Although it may be advisable in certain circumstances, the rules do not actually require it. Accordingly, a VCOC can obtain management rights pursuant to the applicable investment documents, pursuant to the government documents of the portfolio company, pursuant to a separate VCOC management rights letter or other contractual agreement, or any combination thereof.

Ira Bogner: Just a couple of other items to be aware of. A VCOC has to have its own direct contractual management rights with respect to the operating company. Generally, rights that it shares with another entity, such as a parallel fund or co-investor, will not satisfy the requirements. Further, if the VCOC is investing indirectly into an operating company, for example through a wholly-owned blocker, you'll need to make sure that even though the VCOC is investing indirectly, it still obtains direct contractual management rights with respect to the operating company.

Adam Scoll: And those are two great reasons why sometimes having a separate VCOC management rights letter agreement can be really helpful. With a separate agreement you'll have more control and visibility as to making sure your VCOC has its own rights and is being granted rights by and with respect to the correct parties. Another benefit is that a separate VCOC management rights letter agreement typically cannot be amended without the VCOC's consent, which may not always be the case for other investment or governing documents with many parties.

Ira Bogner: And don't forget, simply obtaining direct contractual management rights is not the end of the story. In order to qualify as a VCOC, the VCOC must actually exercise such management rights with respect to one or more such operating companies in the ordinary course of its business. An example in the plan assets regulation indicates that a VCOC can satisfy this requirement by routinely consulting informally with and advising the management of an operating company, and devoting substantial resources to such consultations.

Adam Scoll: Thanks, Ira. That concludes our discussion of VCOC "Management Rights." Thank you all for joining us on the Proskauer Benefits Brief, stay tuned for more legal insights on Employee Benefits and Executive Compensation, and be sure to follow us on iTunes, Spotify and Google Play.

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